NORTON ROSE FULBRIGHT

Some further reflections on the Commission communication: The simple story?

July 2020

Introduction

On July 9, 2020, the European Commission issued a communication on readiness at the end of the transition period between the EU and the UK. In the communication, the Commission refers to little progress in the negotiations so far on the UK/EU free trade agreement (FTA) arguing that all stakeholders should be made aware of this and that they should be ready for changes that arise under any scenario. The communication throws into question the ability of financial services firms in either the UK or the EU to conduct certain cross-border business into each other's territory for some time. The Commission advises EU businesses to revisit their existing preparedness plans as even though these were prepared for a no-deal Brexit, part of them will still be very relevant should the transition period end and the UK and EU not enter into a FTA.

No Commission equivalence decisions in the short- or medium-term

Perhaps the most concerning part of the communication for financial institutions was the statement made at the top of page 15 where the Commission states that it will not adopt equivalence decisions in the "short or medium" term in those areas set out further in footnote 21. Whilst it's unclear what exactly the Commission means by "short or medium term," the list of directives and regulations covered in footnote 21 may trouble financial services firms. These are:

- Directive 2004/109/EC - Transparency Directive - Accounting Standards; Art. 23(4) first subparagraph, point (ii).
- Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (Statutory Audit); Art. 45(6) - Equivalence to the international auditing standards of the standards and requirements in the third country.
- Regulation (EU) N° 600/2014 on markets in financial instruments (MIFIR); Art. 33(2) - Derivatives: trade execution and clearing obligations; Art. 38(3) - Access for third-country trading venues and CCPs; Art. 47(1) - Investment firms providing investment services to EU professional clients and eligible counterparties.
- Directive 2014/65 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID 2 – recast; Art. 25(4) - Regulated markets for the purposes of easier distribution in the EU of certain financial instruments.
- Regulation (EU) No 596/2014 on insider dealing and market manipulation (Market Abuse Regulation); Art.6(6) - Exemption for climate policy activities.
- Regulation (EU) No 236/2012 on short selling and certain aspects of Credit Default Swaps; Art. 17(2) - Exemption for market making activities.
- Regulation (EU)2017/1129 of June 14, 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC; Art. 29(3) – Prospectus rules.

A small glimmer of light in the Commission's list above is that Article 23 / Article 28 MiFIR is not mentioned which might provide some welcome relief to investment firms as regards the share trading obligation / derivatives trading obligation (all TBC of course). In addition, the communication refers to the possibility of the Commission adopting a time limited equivalence decision for central clearing counterparties of derivatives. Arguably, such a decision is in the Commission's own interest with the communication noting that such a time limited decision will allow EU-based central counterparties to further their capacity to clear relevant trades in the short- and medium-term.

Following contact between the President of the Commission and the Prime Minister on June 16, there has been an acceleration of the work on the FTA negotiations which must be welcomed. But whether this is enough to change the Commission's view remains to be seen.

The political backdrop

However, whilst the Commission's comments on equivalence are troubling, financial institutions would be well advised to be conscious that in its current guise the communication is part of the political brinkmanship that is part of the Brexit FTA negotiations. This is not in reality a purely legal document when viewed through this prism.

For example, the Political Declaration on the future relationship stated that the EU and the UK would endeavour to conclude their respective equivalence assessments before the end of June 2020.

The communication states that the Commission shared with the UK questionnaires covering 28 equivalence areas and that by the end of June, only four completed questionnaires had been returned. The Commission asserts that on that basis it could not conclude its equivalence assessments by the end of June. When providing evidence to the House of Lords' select committee on the EU for its inquiry into financial services after Brexit, John Glen MP painted a somewhat different picture: "As I said, we have completed our assessment of it. It [the Commission] has sent over 1,000 pages of detailed questionnaires, 248 of those pages as late as the end of May, and we have responded to those at pace. We will be able to conclude that in the next couple of weeks."

The subtext of this is that the UK recognised that the original aim of equivalence by the end of June was never going to happen given the political reality of the state of the negotiations. This explains the Treasury's decision to release its papers on June 23 and places the Commission's statements in context.

Unpacking the meaning of equivalence

Whilst it is acknowledged that the equivalence assessments conducted by the UK and the EU are autonomous processes for each party's authorities, they are nonetheless an essential building block of the future economic partnership for cross-border trade in financial services. The constructions of the political declaration to stabilise cross-border market access would build on these equivalence decisions. Consequently, it is fair to say that these decisions remain bound up in the overall negotiations.

The Commission has also commented that equivalence assessments have a forward looking element, which is also noteworthy for firms. The UK has taken the approach that such assessments should be made on the basis of compliance with international standards and in any event be made at a point in time and not look forward into the future. In addition, whilst recent statements from HM Treasury have indicated that the UK will not be pursuing identical rules in the future there is alignment as regards achieving similar outcomes which in turn gives the EU a degree of clarity for the future.

Whether the Commission will change its approach to equivalence as stated in the communication remains to be seen and will be impacted by the development of negotiations on the FTA. From the UK perspective, HM Treasury will publish a guidance document in the near future on the UK's equivalence framework. In that document the UK Government will set out the principles and processes that it will apply not just to the EU but also the rest of the world.

What this all means in practice?

One of the questions for firms will be how useful any final FTA will be in the absence of equivalence assessments. Access to the EU on the same terms as passporting has always been off the table and the equivalence regimes in various pieces of EU legislation, with their obvious drawbacks, may not now be granted for some time. With this in mind, financial services firms are asking themselves whether an FTA is actually more akin to no deal.

If this is the case, then for EU firms that currently passport into the UK there is the regulatory relief provided by the UK's temporary permission regime (TPR). Such firms need to be reminding themselves of how the UK is onshoring EU legislation and the PRA/FCA near final rules produced last year for the possibility of a no-deal Brexit. There is also expected in September an FCA consultation paper on the authorisation procedure for firms in the TPR. For UK firms that passport into the EU there is no EU wide regime that is comparable to the TPR and instead they will have to rely on any domestic relief measures that EU27 Member States implement (if any). Such firms should also remind themselves of the Commission's Brexit no-deal notices that were previously published (and now being re-issued) plus the supervisory statements that the European Supervisory Authorities issued. In relation to the ESA supervisory statements, it's worth noting that recently the European Central Bank (ECB) issued a Brexit blog to the banks that it supervises reasserting a number of points made in these documents. In particular, the ECB warns that banks that have failed to hire staff with sufficient seniority and skills, neglected to make necessary transfers of material assets, or unduly split trading desks across multiple legal entities, will not be considered as complying with its supervisory requirements.

Contacts

Simon Lovegrove
Global director of Financial services knowledge, Innovation and product
Tel +44 20 7444 3110
simon.lovegrove@nortonrosefulbright.com

Jonathan Herbst
Global head of Financial services
Tel +44 20 7444 3166
jonathan.herbst@nortonrosefulbright.com

Matthew Gregory
Senior associate
Tel +44 20 7444 2467
matthew.gregory@nortonrosefulbright.com

NORTON ROSE FULBRIGHT

Law around the world

nortonrosefulbright.com