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What is the point of equivalence in EU financial services?

Blog post by Adviser Tom White, 08 November 2016

UK commentators have spent recent weeks debating the opportunities offered by the EU's 'equivalence' regime for companies outside the single market. The concept was significantly expanded by Michel Barnier to encourage global adoption of EU rules and simply commits the EU to go beyond its formal WTO commitments for countries that meet its regulatory standards. In the London-centric Brexit debate, it has become a point of contention about the consequences of 'hard Brexit' for the City of London. Advocates of a clean break argue equivalence is a ready-made substitute for single market passports; those aiming for an ambitious UK-EU deal argue it is incomparable to legally-enforceable rights to national treatment, and only offers conditional tolerance for UK-based firms to provide services to institutional investors through a branch in the EU27.

Media reports that the Commission is reviving a 2013 project to revise its approach to equivalence is therefore a reminder that 'market access' in the EU will always be a moving target. It is also a prompt to consider the EU's own objectives in allowing non-EU (and often 'offshore'') financial centres to provide services. The explicit objective of the 2013 review was to provide consistency and legal certainty in assessing regulatory frameworks. The unspoken objectives were more interesting: to enable the Commission to overrule the less politically astute supervisory authorities responsible for assessments; and to empower the Commission to secure concessions on tax information exchange or reciprocal market access, particularly from Switzerland and the United States.

The most informative output of the 2013 review is also the reason it failed to deliver the 'horizontal instrument' desired by many in the Commission. This was that the various equivalence regimes for insurance, audit standards, data protection, investment services and fund management diverged because they reflected differing policy objectives of the EU legislation. At a high level, these all aimed to harmonise prudential regulation, consumer protection and corporate governance as a condition liberalising intra-EU trade, and constrained national regulators' ability to impose additional requirements. But looking at specific directives, it is clear that third-country rules on anti-money laundering are designed to reduce the risk of the financial system being used by criminals, making territorial designations of 'safe' and 'unsafe' countries a useful way of identifying and managing risks. Solvency II seeks to weight the risks and liabilities of insurers, and so a consistent methodology for non-EU assets and liabilities assisted in calculations. Equivalence in banking rules are designed only to ensure capital requirements can be calculated fairly, without providing any market access rights. Meanwhile, the Market in

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Financial Instruments Regulation could only gain support from member states if those that imported some financial services could continue to do so, while the Alternative Investment Fund Managers' Directive had to preserve access to tax neutral fund structures for UK, German and Scandinavian fund managers.

All this matters because, as the UK and its financial sector considers how equivalence might change in future, a crucial consideration is to understand how equivalence might benefit of the EU, rather than how it might benefit the UK. And without the UK at the table, with its 29 Council votes and heavyweight financial services expertise, those EU benefits will be calculated very differently. While there may be some grounds for UK hope that the review will deliver extra certainty and 'permanence' of equivalence judgements, it is as likely to create more flexibility and power for the EU27. Given that equivalence goes beyond the EU's formal WTO commitments, its 'purpose' will be whatever the EU27 want it to be.

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