Equivalence vs Passporting

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What does it mean for asset management

In the event of a 'no deal' Brexit, the UK would become a third country and UK financial services firms would lose their passport rights and access to the single market for financial services.

Following a 'no deal' Brexit, in order for UK firms to access the EU market and provide financial services, they would need to rely on third country equivalence provisions in the EU acts. Some Member States have approved or have made announcements that they intend to introduce measures to provide transitional relief post-Brexit; these are however, interim in nature.

Only certain EU acts contain third country equivalence provisions and in some acts these provisions are not switched on (e.g. under the AIFMD). In comparison to passport rights, equivalence offers piecemeal and limited access to the single market. Furthermore, unlike passport rights, which are permanent, equivalence may be unilaterally withdrawn by the European Commission (the 'EC').

In order for UK firms to rely on third country equivalence provisions in the respective EU acts, certain conditions would need to be met. One of them is that the UK would need to apply for equivalence under each of the respective EU acts and the equivalence would need to be granted by the EC.

Passport rights

EU passport rights allow financial services firms in Member States access to the single market for financial services. A financial services firm authorised by its domestic regulator can provide services or establish a branch in any other EU Member State without the need for any further authorisation or licence in that Member State.

Equivalence

There is no single concept of equivalence. It is only available where third country equivalence provisions are included in the respective EU acts. In many EU acts equivalence provisions do not exist and where they do exist, they are mainly technical and narrow in scope and do not provide passport-like access. Table A overleaf outlines a high level summary of passport rights and third party equivalence provisions under UCITS, AFIMD and MiFID.

How is equivalence determined?

Equivalence is determined by assessing if a third country's rules and supervisory mechanisms are equivalent to the EU regulatory regime and achieve the same results as the EU regime. Assessment of equivalence is carried out by the EC taking into account technical advice from bodies such as ESMA.

In order for the UK to be granted equivalence by the EC, each of the UK regulatory regimes would need to achieve the same regulatory objective as the respective EU regime (that contains third country equivalence provisions). This would be based on the interpretation of EU bodies and not the FCA. At present, UK firms are subject to EU law, which is transposed into UK law and/or interpreted by the FCA.

How long can equivalence take?

Obtaining equivalence is an uncertain process that can take a long time. Factors other than technical differences in laws/ regulations (e.g. political reasons or reciprocity by the third country) could impact equivalence.

The process of obtaining EMIR equivalence for US CCPs took some four years. Given the close alignment of the UK regulatory regime to the EU regime, it is arguable that the process of obtaining equivalence for the UK regulatory regime may not be as long.

Can the equivalence decision be reversed?

Equivalence is made at a point in time and can be unilaterally withdrawn by the EC. This could make long term planning based on equivalence hard.

If the UK is granted equivalence, maintaining equivalence could be challenging as the UK may have to adopt future EU laws without having an influence in the design of such laws. Given UK laws are mostly aligned with EU laws, the UK may not be able to diverge from EU laws without the risk of losing equivalence.

Rights granted under EEA model?

An EEA member can rely on EU passport rights to access the single market for financial services if they accept and implement all relevant EU rules and regulations in relation to financial services including any amendments.

EEA members have the opportunity to influence the shaping of EEA relevant legislation, i.e. to participate in expert groups of the EC and submit comments on upcoming legislation. However, in terms of the final decision on the legislation on the EU side, they have little influence when compared to being a full EU member.

Member states' 'no deal' Brexit preparations

Some member states in the EU have approved specific domestic legislation or have made announcements stating that they intend to introduce measures to provide transitional relief in a 'no deal' scenario. For example,

- Germany is looking to introduce transitional measures for UK banks, insurers and other financial market participants until the end of 2020 – 2021.
- The Netherlands has introduced draft catch-all legislation to introduce measures in the event of a 'no deal' Brexit with unforeseen consequences.
- Finland has introduced a draft proposal to create a new third country regime allowing UK firms to continue providing cross-border investment services and ancillary services without establishing a branch.
- Italy is looking to adopt an emergency decree in a 'no deal' scenario to introduce temporary measures to apply to financial institutions, MiFID firms, other financial intermediaries, insurance companies and pension funds, which will be permitted to continue operating in Italy for a transitional period.

Table A

	UCITS	AIFMD	MiFID II
UK access via EU passports	UK ManCos can manage UCITS across EU member states. UK ManCos can market UCITS to investors across the EU (including retail investors).	UK AIFMs can manage AIFs across EU member states. UK AIFMs can market AIFs to EU professional investors.	UK MiFID firms can provide investment services (e.g. investment advice, portfolio management etc.) across the EU either on a cross-border basis or by establishing a branch.
UK access via third country equivalence provisions	No equivalence regime in place.	Includes third country equivalence provisions that allow third country AIFMs to manage EU AIFs and market EU or non-EU AIFs in the EU (to professional investors), subject to compliance with certain conditions. However, these third country equivalence provisions are not switched on.	Includes third country equivalence provisions that allow investment firms to provide investment services to per se professional clients and eligible counterparties across the EU[1], subject to compliance with certain conditions. There is no need to establish a branch in the EU. However, these third country equivalence provisions are mostly untested.

[1] UK AIFMs and UCITS ManCos may not be able to benefit from MiFID II/MiFIR third country passport, which may not be available to managers of collective investment undertakings.