



## **EU EQUIVALENCE: THE UK'S REGULATORY PATHWAY BACK TO EUROPEAN CAPITAL MARKETS**

*A departure from the EU resulted in the loss of simplified access to many European markets, but through key regulatory compliance angles, the UK could regain access to this crucial space*

During membership of the EU and European Economic Area (EEA), the UK was required to comply with EU legislation, which in turn granted it access to the EU 'passport'<sup>1</sup>. The passport allowed for free access to capital markets across all EU member states. With Britain's departure from the EU, free access to the single market was withdrawn, forcing the UK into a 'third country' status.

Since Brexit, UK legislation and regulation is no longer viewed as implicitly equivalent to that of the EU's, as the UK was no longer obliged to comply with the EU's regulatory structure. Financial institutions are now required to fulfil further third country criteria, such as gaining formal 'equivalence' status from the EU Commission, in order to trade freely and operate within the EU. While the UK's legislation may be equivalent in real terms, it cannot obtain the passport without an official equivalence decision from the EU, which has not yet been granted. As many UK firms have customers or clients based in the EU, access to EU capital markets is essential, emphasising the need to regain equivalence status.

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<sup>1</sup> NB this is not a physical passport, it is purely for explanatory purposes

## Accessing EU Capital Markets

Third country firms have three potential ways to access EU capital markets:

| Option | Action  |
|--------|---|
| 1      | Become an EU firm, entailing compliance with EU regulations |
| 2      | Gain access through a "Free Trade Agreement"                |
| 3      | Gain Third Country Equivalence                              |

### *Option 1: Become an EU firm, entailing compliance to EU regulations*

This option is not always practical; it would require the UK firm to establish a branch (including management and governance structures) in an EU member state. If the UK firm does not have the capital or resources to expand, then it would require a redistribution of branches. This means that some UK-based clients may lose their local branch and potentially move to another UK firm, resulting in loss of business for that UK firm. More broadly, if the firm were to move a branch to the EU, this may result in a loss of capital from the UK to the EU.

### *Option 2: Gain access through a Free Trade Agreement*

This option is also not viable, based on Free Trade Agreement negotiations. Prior to the UK's exit from the EU, the ensuing EU-UK Trade and Cooperation Agreement (TCA) does not currently allow general access to capital markets. The current agreement centres on topics, including fishing rights negotiations, trade of goods, movement of people, aviation, and transport etc.. As a result, use of existing Trade Agreements is not a viable option.

### *Option 3: Gain Third Country Equivalence*

Gaining Equivalence is the most practical option available to the UK. Equivalence describes a decision by the EU Commission, stating that a third country has registered with the European Securities and Markets Authority (ESMA) and that the laws and regulations are in line with that of the obligations coming from the EU. This decision can only be made by the EU Commission, regardless of whether third country legislation is equivalent in real terms. For example, even if the legislative requirements are largely the same, a third country will not receive a passport (to gain access to capital markets) unless the EU Commission formally agrees. Note that equivalence is only available in certain elements of EU legislation, including the 'MiFI' (Markets in Financial Instruments) regulatory framework, which governs investment firms acting within capital markets. This means that, firms wanting access to areas, other than capital markets and investment services, such as banking, may only have options 1 and 2 to access the EU.

## Gaining EU Equivalence

Once deemed equivalent, any UK investment firm defined under MiFID, will be granted a passport, allowing them to provide services across all EU member states. However, firms must continue to demonstrate their compliance with certain EU requirements, such as:

- binding prudential and conduct requirements
- ongoing supervision from a regulator
- maintaining initial capital requirements
- adhering to market abuse requirements

The process for granting the actual passport is outlined below:

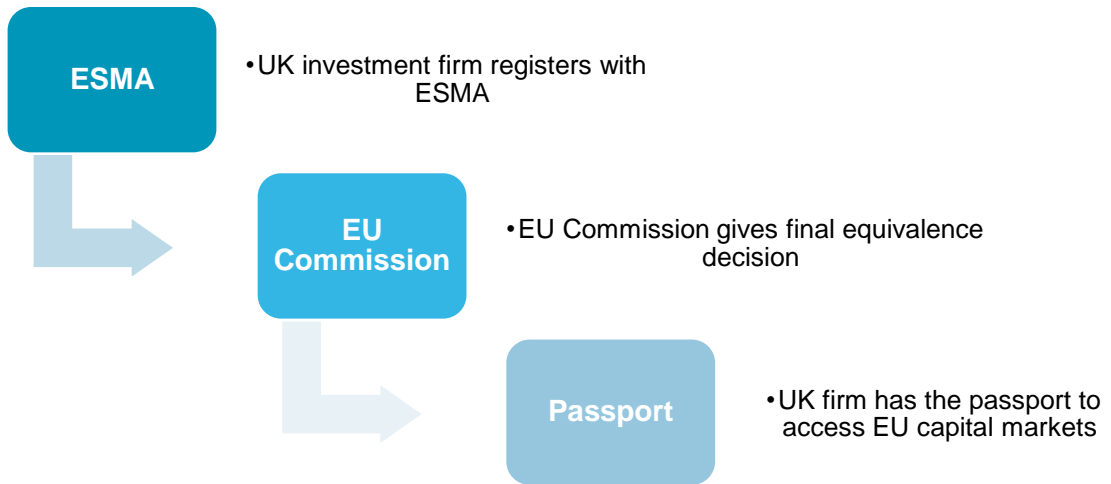


Diagram 1: Process for a UK investment firm to gain access to EU through Equivalence

The UK has its own MiFI framework which is now separate to the EU’s MiFI framework. This framework sets out the obligations for investment firms, when operating in capital markets. If UK investment firms want to access EU capital markets, through the use of the passport, the EU Commission will have to find the UK MiFI framework to be equivalent to that of the EU. This includes the UK legislation aspect of the MiFI framework, which broadly gives obligations to the UK regulator – the FCA, and at the regulatory aspect of the framework (i.e. rules in the FCA Handbook), which in turn outlines the obligations for UK firms.

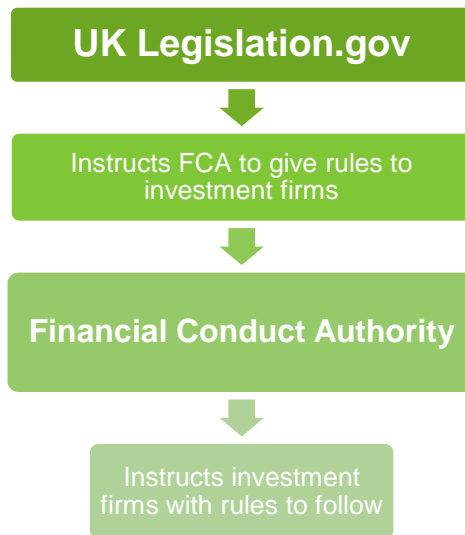


Diagram 2: UK regulatory framework

The diagram below shows how the MiFI framework differs before and after Brexit for the UK:



Diagram 3: Significant capital markets rules pre and post Brexit

Significant changes to the UK's MiFID framework, indicate some divergence from the EU MiFI framework, such as:

| Implementing Body | Relevant Document   | Date of change     |
|-------------------|---|--------------------|
| FCA               | Changes to UK MIFID's conduct and organisational requirements | November 2021      |
| HM Treasury       | Statutory Instrument 2021/774                                 | July-December 2021 |
| HM Treasury       | Wholesale Markets Review                                      | March 2022         |

Although there are some material changes, it may be interpreted that the UK is enjoying independence from the EU, through the creation of their own regulatory framework for capital markets (leveraging the infrastructure built during EU membership) whilst toeing the line in order to be found equivalent by the EU Commission. The UK most likely foresaw the benefit of an equivalence decision and, as such, has not wanted to cut itself off from the opportunity to access EU capital markets.

### Update on EU Equivalence Decision

Unfortunately, while the UK may be in a hurry to regain access, the EU Commission is under no compulsion to make any equivalence decisions at any time. The latest equivalence decision was made in February 2021, at which time the UK was only found to be equivalent in two areas of capital markets regulation (unrelated to the MiFI framework for investment firms):

1. [Regulation \(EU\) No 648/2012](#) on OTC derivatives, central counterparties and trade repositories (EMIR), as amended Art.25(6) – affecting Central Clearing Parties
2. [Regulation \(EU\) No 909/2014](#) of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories, as amended Art. 25(9) – affecting Central Securities Depositories

As it stands, the UK does not have EU equivalence, despite the MiFI frameworks being broadly the same in the EU and the UK. The UK will need to persevere in its attempt to be found equivalent to the EU in the capital markets space and the timelines for this remain unknown.

Given the changes to the UK's regulatory framework surrounding capital markets, it is imperative for UK firms to keep on top of their obligations so as not to be found in breach which may result in financial penalties from regulators, like the FCA. Failure to maintain compliance could damage a firm's reputational capital and potentially give the EU the ammunition to refuse the UK access to EU capital markets, adding to their apparent reluctance to grant the UK with an equivalence decision.

## The leading Financial Crime Compliance solution: Plenitude RegSight

The regulatory framework is clearly complex, and constantly evolving. To address the challenges associated with managing regulatory obligations, Plenitude has developed **RegSight**; an innovative cloud-based obligations management solution. RegSight captures laws, regulations and guidance that apply in the UK in relation to market integrity i.e. regulating capital markets. More broadly it also contains obligations related to Financial Crime Compliance and Data Protection for multiple jurisdictions. RegSight is regularly updated to ensure any changes or new laws, regulations or guidance are captured and our clients are proactively notified of these changes on a monthly basis.

RegSight allows firms to keep up to date with regulations, whether or not the UK stays close to the EU MiFI framework (in the anticipation of gaining an EU equivalence decision) or if the UK decides to diverge further from the EU and regulate its capital markets independently. Learn more about [RegSight](#).

If you would like more information regarding RegSight or to schedule a product demo, please contact [Plenitude](#).

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