UK FINANCE

CLIFFORD CHANCE

TECHNICAL BRIEFING:

WHAT THE MIFIR THIRD-COUNTRY REGIME MEANS FOR UK-EU CROSS-BORDER SERVICES

June 2020

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INTRODUCTION

The withdrawal agreement concluded by the UK and the EU provides for a transition period scheduled to end on 31 December 2020 (the transition period). After that, UK-incorporated banks and investment firms (UK firms) will no longer be able to rely on their EU 'passports' to provide services in the EU without local authorisation. Similarly, EU-incorporated banks and investment firms (EU firms) will no longer be able to rely on their EU 'passports' to provide services in the UK without UK authorisation.

The UK has put in place temporary measures to mitigate the impact of this 'cliff-edge' change in regulatory status on EU firms and their UK clients and counterparties. In any event, UK law generally allows non-UK firms to provide cross-border investment services to a broad range of UK institutional clients and counterparties without the need for UK authorisation.

In contrast, UK firms seeking to provide services to EU clients and counterparties after the transition period will face a 'patchwork' of differing national licensing regimes across the EU, many of which are highly restrictive of cross-border services even when those services are provided to institutional clients and counterparties. Some EU member states did adopt temporary regimes to mitigate the impact of the 'cliff-edge' change on UK firms and their local clients and counterparties if the UK left the EU without concluding a withdrawal agreement, but most, if not all, of these regimes ceased to apply when the withdrawal agreement entered into force.

The trade agreement being negotiated between the UK and the EU is unlikely directly to mitigate the impact of these cliff-edge changes on UK or EU firms. However, the EU Markets in Financial Instruments Regulation (MiFIR) allows third-country (non-EU) firms registered with the European Securities and Markets Authority (ESMA) to provide cross-border services to eligible counterparties and certain professional clients (qualifying clients) in the EU if the European Commission (Commission) makes an equivalence decision in respect of the third country concerned.

This briefing discusses how this regime operates and the implications for UK firms if the Commission makes an equivalence decision in respect of the UK under MiFIR, including the impact of the amendments to the regime that will apply from 21 June 2021 under the EU Investment Firms Regulation (IFR). It also discusses the implications for EU firms if the UK makes a corresponding equivalence decision in respect of the EU under the 'onshored' MiFIR, i.e., MiFIR as it forms part of UK domestic law after the end of the transition period under the European Union (Withdrawal Act) 2018.

The EU and the UK have indicated that they are carrying out equivalence assessments of each other under their existing legislative frameworks with a view to concluding these before the end of June 2020. This may lead to their making equivalence decisions under those frameworks, including under MiFIR, effective from the end of the transition period.

The adoption by the Commission of an equivalence decision in respect of the UK under MiFIR would allow UK firms to provide cross-border services covered by the Markets in Financial Instruments Directive (MiFID) to qualifying clients in the EU regardless of national licensing regimes. However, UK firms may still need to continue to implement their plans for relocation of activities to EU affiliates in order to provide services to EU clients and counterparties:

- The Commission might not make its equivalence decision until near the end of the transition period and, even if it does, the decision might not cover all MiFID services and ESMA might not process UK firms' applications for registration until after the end of the transition period.
- UK firms that register with ESMA will not be able to rely on that registration to provide services to EU clients that are not qualifying clients or to provide regulated services not covered by MiFID to EU clients or counterparties.
- UK firms are not treated the same as passported EU firms for all purposes. Other EU or UK rules may inhibit their ability to conduct business with qualifying clients in the EU.
- In addition, UK firms registered with ESMA may need contingency plans to address the risk that the Commission withdraws an equivalence decision, perhaps on little or no notice.

The adoption by the UK of an equivalence decision in respect of the EU under the 'onshored' MiFIR would have less impact as EU firms could choose to rely on the UK's temporary measures in the short term. In the longer term, an equivalence decision would result in EU firms being subject to registration and ongoing requirements when providing services to UK qualifying clients that do not apply to other non-UK firms. In any event, other UK or EU rules may inhibit the ability of EU firms to conduct business with qualifying clients in the UK.

This briefing assumes that the EU and the UK do not agree to extend the transition period beyond 31 December 2020. References in this briefing to the EU include the EEA (and assume that IFR is incorporated into the EEA Agreement by June 2021). This briefing does not discuss any issues relating to taxation.

BOX 1: THE MIFIR THIRD-COUNTRY REGIME IN SUMMARY

If the Commission makes an equivalence decision in respect of the UK, UK firms will be able to provide MiFID investment and ancillary services to eligible counterparties and certain professional clients in the EU, subject to registration with ESMA.

Registration would not allow UK firms to provide MiFID services to retail clients or to provide other regulated services in the EU.

UK firms would be able to register with ESMA if they are authorised and supervised in the UK and ESMA has concluded cooperation arrangements with the UK authorities.

ESMA can take up to around nine months from when an application is complete to conclude registration, so there may be a gap between the end of the transition period and completion of a firm's registration.

Currently, registered firms only have to file limited information with ESMA and to comply with conditions as to status disclosure and dispute resolution arrangements with clients.

Firms registered with ESMA are not treated the same as passported EU firms for all purposes. Other EU or UK rules may inhibit their ability to conduct business with qualifying clients in the EU.

ESMA can withdraw a firm's registration where the firm acts in a manner clearly prejudicial to investors' interests or the orderly functioning of markets or seriously infringes relevant UK requirements.

If the Commission makes an equivalence decision in respect of the UK:

- UK firms can continue to provide cross-border services in the EU for up to three years in reliance on national licensing regimes;
- UK firms with an EU branch authorised under MiFID can provide MiFID services from that branch to qualifying clients in other EU member states.

The Commission can make partial equivalence decisions (covering only some types of services) and can withdraw an equivalence decision at any time with little or no notice.

From 21 June 2021, IFR will amend the regime to require:

- the Commission to make 'detailed and granular' equivalence assessments of systemically important third countries;
- registered firms to provide more extensive information to ESMA and to comply with record-keeping and inspection obligations;
- registered firms from systemically important third countries to comply with transparency, transaction reporting and trading obligations (at the option of the Commission).

Sources: Articles 46 to 49 and 54(1) MiFIR and Article 63(4), (5), (6) and (8) of IFR.

HOW IS EQUIVALENCE GRANTED?

UK firms will not be able to make use of the regime unless the Commission adopts an equivalence decision stating that:

- the UK's legal and supervisory arrangements ensure that UK firms comply with legally binding prudential and business conduct requirements which have equivalent effect to EU requirements under MiFIR, MiFID and the Capital Requirements Directive (CRD); and
- the UK legal framework provides for an effective equivalent system for the recognition of foreign authorised firms.

From June 2021, the equivalence decision must also address whether:

- the UK's legal and supervisory arrangements ensure that UK firms comply with legally binding prudential, business conduct and organisational requirements which have equivalent effect both to the EU requirements mentioned above and those under IFR, the Investment Firms Directive (IFD) and the Capital Requirements Regulation (CRR); and
- UK authorised firms are subject to effective supervision and enforcement under those requirements.

MiFIR states that the Commission may consider that the UK's framework is equivalent for these purposes if:

- UK firms are subject to:
  - authorisation and effective supervision and enforcement on an ongoing basis;
  - sufficient capital requirements (from June 2021, firms engaging in dealing on own account, underwriting or firm commitment placing must be subject to comparable capital requirements to those applicable to EU firms);
  - appropriate requirements applicable to shareholders and members of their management body;
  - adequate business conduct and (from June 2021) organisational requirements; and
- the UK ensures market transparency and integrity by preventing market abuse in the form of insider dealing and market manipulation.

The Commission's decision will be taken in accordance with the 'examination procedure' which gives EU member state representatives in the European Securities Committee the opportunity to block the decision. The Commission will normally publicly consult for four weeks before adopting an equivalence decision.

From June 2021, the Commission will be required to carry out a 'detailed and granular assessment' of the UK framework if it concludes that the scale and scope of the services provided by UK firms in the EU are likely to be of systemic importance for the EU. This assessment must also take into account the degree of supervisory convergence between the UK and the EU and whether the UK legal framework provides for criteria for the designation of trading venues as eligible for compliance with the trading obligations for shares and derivatives which have a similar effect to the EU regime. In addition, the Commission must take into account whether the UK has been identified as a non-cooperative jurisdiction for tax purposes or a high-risk jurisdiction for anti-money laundering purposes under EU policy and legislation.

The Political Declaration agreed between the EU and the UK in October 2019 stated that the parties should endeavour to conclude their equivalence assessments with respect to each other under their existing legal frameworks for equivalence before the end of June 2020. However, it did not commit the parties to taking equivalence decisions based on their assessments. The Commission has stated that it considers that equivalence decisions are relevant for the future relationship, but not subject to negotiations.

The Commission has stressed that its equivalence decisions are unilateral and discretionary decisions that it takes in accordance with EU priorities and interests following a risk-based and proportionate assessment. The Commission also has stated that it can restrict the scope of, or impose time limits or other conditions on, an equivalence decision even where this is not expressly contemplated by the legislation. [1]

Therefore, it is possible that the Commission may decide not to make an equivalence decision before the end of the transition period - or at all - even though the UK plans to 'onshore' all then applicable EU legislation from the end of that period so that the UK regulatory and supervisory framework is substantially identical to that in the EU at that point. Even if the Commission does adopt a decision, it may limit the scope of that decision to particular MiFID services. If the Commission adopted a partial equivalence decision of this kind, UK firms would not be able to rely on registration with ESMA to provide MiFID services not covered by the decision.

The Commission may also link any continuation of that decision to the UK's adoption of prudential rules for investment firms comparable to those in IFR and IFD or other continued convergence of the UK framework with EU legislation.

The Commission may take into account a number of factors going beyond the alignment between the UK and the EU regulatory and supervisory frameworks at the end of the transition period. An equivalence decision under MiFIR would give EU qualifying clients access to a broader and deeper range of MiFID services provided by UK firms than may be provided by those firms' smaller and less highly capitalised EU affiliates. It would also provide the UK with an incentive to keep its regulatory and supervisory framework more closely aligned with the EU's framework and provide a context for closer regulatory and supervisory cooperation between EU and UK authorities. The making of an equivalence decision may also not have a significant impact on UK firms' implementation of their plans to relocate activities to the EU given the advanced state of their implementation of those plans.

1. Commission staff working document, EU equivalence decisions in financial services policy: an assessment (February 2017), here.

The Commission has not yet made any equivalence decisions under the MiFIR third-country regime (although the EU's trade agreement with Canada contemplates a limited equivalence decision for Canadian firms providing portfolio management services to EU funds after a transitional period).[2] If the Commission takes a decision in respect of the UK, it will need to consider whether it should also make equivalence decisions in respect of other third countries. The General Agreement on Trade in Services (GATS) allows the EU to recognise the prudential measures of any other country in determining how its financial services regime is applied.[3]

Where it does so autonomously (rather than by an agreement), it must afford other members of the World Trade Organisation (WTO) an 'adequate opportunity' to demonstrate that circumstances exist in which there would be equivalent regulation, oversight, implementation of regulation, and, if appropriate, information-sharing procedures. However, the special circumstances of the UK may mean that it would be difficult for other WTO members to demonstrate equivalent circumstances.

2. Paragraphs 15 and 16, EU Schedule, Annex 13-A, EU-Canada Comprehensive Economic Trade Agreement, here.
3. Paragraph 3, Annex on Financial Services of the GATS, here.

WHAT DOES REGISTRATION ALLOW?

UK firms that register with ESMA will be able to provide MiFID investment and ancillary services (see Box 2) covered by the Commission's equivalence decision to EU qualifying clients on a cross-border basis without the need for further authorisation in the EU. EU qualifying clients comprise eligible counterparties and professional clients other than those which have been opted-up from retail status (see Box 3).

Therefore, UK firms registered with ESMA would be able to service some securities and derivatives business with EU qualifying clients after the end of the transition period that would otherwise need to be serviced through EU branches or affiliates. In particular, UK firms could act as the booking entities for some larger derivatives and securities transactions with EU qualifying clients, where their EU affiliates may face capital, large exposure or liquidity constraints in servicing the business. It would also provide UK firms with more flexibility around the location of staff in their capital markets or investment banking businesses, as the regime would facilitate the use of UK-based staff to provide some corporate finance and M&A advisory services to EU qualifying clients.

Registration will not allow UK firms to:

- provide MiFID investment and ancillary services to EU clients that are not qualifying clients (e.g., individuals, small companies, municipalities and local public authorities);
- provide MiFID ancillary services on a standalone basis (i.e., without also performing MiFID investment services or activities);
- provide other regulated services, such as deposit-taking, lending, unconnected spot foreign exchange, payment services, etc.

UK firms wishing to provide MiFID services to EU clients that are not qualifying clients may be required to establish a branch in the relevant member state or to transfer these activities to an EU affiliate unless they are providing those services at the 'own exclusive initiative' of the client. In addition, UK firms may need to conduct activities in an EU branch or affiliate where those activities involve the provision of other regulated services to EU clients.

BOX 2: MIFID SERVICES

INVESTMENT SERVICES AND ACTIVITIES

- Reception and transmission of orders
- Execution of orders
- Dealing on own account
- Portfolio management
- Investment advice
- Underwriting and firm commitment placing
- Operation of multilateral trading facilities and organised trading facilities

In relation to:

- Securities (incl. equities and bonds)
- Money market instruments
- Units in funds
- OTC and exchange-traded derivatives
- Emission allowances

ANCILLARY SERVICES

- Custody
- Margin lending
- Corporate finance and M&A advice
- Foreign exchange connected to investment services
- Investment research
- Services related to underwriting
- Services related to commodities underlying derivatives

BOX 3: EU QUALIFYING CLIENTS

	ELIGIBLE COUNTERPARTIES	PROFESSIONAL CLIENTS
Authorised financial institutions	✓	✓
National governments and public debt management bodies	✓	✓
Central banks and supranational organisations	✓	✓
Large undertakings	✓*	✓
Regional governments and public debt management bodies	✓*	✓
Other institutional investors, including securitisation and financing SPVs	✗	✓

Classification of an entity as an eligible counterparty is subject to the entity's right to request treatment as a professional client or express consent to treatment as such.

Authorised financial institutions includes investment firms, banks, insurance companies, UCITS, alternative investment fund managers and pension funds.

Large undertakings must meet two of the following on a company basis: total assets of €20m; net turnover of €40m; own funds of €2m.

* At member state discretion.

HOW CAN UK FIRMS REGISTER?

PROCESS AND TIMING

UK firms seeking to rely on the regime must submit an application to ESMA for registration in ESMA's register of third-country firms (after the adoption of the Commission's equivalence decision). ESMA must confirm within 30 working days (about six weeks) if an application is complete and, if not, must set a deadline for the submission of additional information. Once a firm's application is considered complete, ESMA will have up to 180 working days (about nine months) to make a decision on registration.

Therefore, even if the Commission makes an equivalence decision with respect to the UK before the end of the transition period, there could be a disruptive hiatus (gap) of up to almost a year after the end of the transition period before UK firms are able to register with ESMA. Unless ESMA makes arrangements to allow UK firms to apply for registration before the end of the transition period and for registrations to take effect from the end of the transition period, UK firms may have to fully implement their plans to transfer activities to their EU branches or affiliated entities by the end of the transition period or rely on available national regimes permitting continued cross-border business after the end of the transition period pending completion of their registration with ESMA.

However, UK firms can choose to continue to provide services to qualifying clients in the EU in reliance on national licensing regimes permitting cross-border business for three years after the adoption of an equivalence decision. IFR will make clear, from June 2021, that UK firms can also continue to rely on national licensing regimes after an equivalence decision in respect of any services not covered by the equivalence decision (e.g., if the Commission makes a partial equivalence decision that only covers some MiFID investment or ancillary services provided by UK firms).

INFORMATION TO BE SUBMITTED

MiFIR currently requires non-EU firms to submit a relatively limited range of information when applying for registration with ESMA. However, ESMA has consulted on new requirements for firms registering with ESMA from June 2021 which would require applicants to submit significantly more information at the time of registration (via an online interface to be set up by ESMA). See the Annex for more details.

CONDITIONS FOR REGISTRATION

In order to register with ESMA, a UK firm must:

- have its head office in the UK;
- be authorised in the UK to provide the MiFID services it intends to provide in the EU;
- be subject to effective supervision and enforcement ensuring full compliance with applicable UK requirements.

UK firms will only be able to register with ESMA if they would be banks performing MiFID investment services or activities or investment firms covered by MiFID if their head office or registered office were located in the EU. Therefore, UK UCITS management companies and alternative investment fund managers would not be able to register with ESMA under this regime – although these firms might be considered eligible if they also provide segregated portfolio management or investment advisory services to EU clients.

From June 2021, it will also be necessary for UK firms to demonstrate that they have established the necessary arrangements and procedures to report annually to ESMA (see below).

ESMA cannot register a UK firm under the regime unless ESMA has established cooperation arrangements with the UK authorities meeting the requirements set out in MiFIR (which will be extended from June 2021). These arrangements will be additional to the other memoranda of understanding entered into between ESMA and other EU and member state supervisors and the UK authorities in 2019 in anticipation of the UK's exit from the EU.

WHAT ONGOING OBLIGATIONS APPLY?

UK firms that register with ESMA will be subject to few ongoing obligations under the current regime – but more extensive requirements will apply from June 2021 (see Box 4). UK firms seeking registration with ESMA will need to put in place new systems and controls to enable them to comply with these requirements, especially to repaper clients with new status disclosures and dispute settlement provisions and to comply with the additional information and duplicative transparency and transaction reporting requirements that may apply from June 2021. In particular, ESMA has consulted on proposals for registration and annual information requirements that go significantly beyond the minimum requirements set out in IFR.

MiFIR provides that EU member states must not impose any additional requirements that fall within the scope of MiFID/MiFIR on non-EU firms registered with ESMA (for example, organisational, conduct of business, transparency and transaction reporting requirements). However, UK firms may need to comply with national rules that fall outside the scope of MiFID/MiFIR. UK firms will also need to comply with prospectus, fund marketing, market abuse, short selling and other rules that apply generally to business conducted in the EU.

BOX 4: ONGOING OBLIGATIONS FOR UK FIRMS REGISTERED WITH ESMA

REQUIREMENT	CURRENT REGIME	AMENDED REGIME (FROM JUNE 2021)
Information requirements	Firms must inform ESMA within 30 days of certain changes to information provided on registration (see the Annex for more details).	Extensive annual reporting requirements apply (see the Annex for more details). ESMA may also request additional information where necessary for ESMA or member state authorities to fulfil their tasks.*
Conduct requirements	Before providing services to EU qualifying clients, firms must: • provide the client with a prescribed disclosure on the firm's regulatory status; and • offer to submit disputes with the client to a court or arbitral tribunal in the EU. Firms must avoid behaviour that is prejudicial to the interests of EU investors or the orderly functioning of EU markets and must comply with relevant UK requirements, otherwise ESMA may withdraw their registration.	Same as current regime.
Record-keeping requirements	None.	Firms must maintain records of all orders and transactions in financial instruments in the EU for five years.
Inspection rights	None.	Firms must give ESMA access to their records of orders and transactions and, in effect, allow ESMA to carry out onsite inspections.*
Transparency, transaction reporting and trading obligation requirements	None.	If it identifies the UK as a systemically important third country, the Commission may require UK firms to comply with: • post-trade transparency requirements; • transaction reporting requirements; • the share trading obligation; and/or • the derivatives trading obligation.
Product intervention measures	None.	Firms must comply with any product intervention measures imposed by ESMA, the European Banking Authority or member state authorities.*†

* ESMA may temporarily prohibit or restrict a registered firm's ability to provide MiFID services to EU qualifying clients if the firm does not comply with these requirements or does not cooperate with an investigation or onsite inspection.

† Product intervention measures will also apply to non-EU firms providing MiFID investment or ancillary services in the EU under national licensing regimes.

DOES REGISTRATION REPLACE THE PASSPORT?

Registration with ESMA would allow UK firms to provide cross-border MiFID services to qualifying clients in the EU without separate authorisation in the EU. However, UK firms will not be in the same position as EU banks and investment firms providing cross-border MiFID services to clients under their CRD or MiFID passports.

Other EU or member state rules – or UK rules – may apply in ways that inhibit the ability of UK firms to provide cross-border services to EU qualifying clients. See Box 5 for some examples drawn from EU and UK rules. Furthermore, UK firms will not benefit from the same general protections as EU firms against discriminatory treatment under EU or member state law.

In some cases, equivalence decisions made by the EU (or the UK) may mitigate the impact of these rules. The statutory instruments adopted in the UK in relation to the 'onshoring' of EU legislation or the directions given by the Prudential Regulation Authority (PRA) or the Financial Conduct Authority (FCA) using their temporary transitional powers under those statutory instruments may also mitigate some of the impact arising from the 'onshoring' of EU rules into UK law. There may also be scope for the Commission, ESMA or the UK authorities to interpret the rules in a way that mitigates some of the adverse impact.

UK firms will need to assess whether these or other rules make it more advantageous to conduct particular categories of activity through a branch or affiliate in the EU even if the Commission adopts an equivalence decision under MiFIR with respect to the UK.

BOX 5: EXAMPLES OF EU OR UK RULES INHIBITING CROSS-BORDER BUSINESS BY UK FIRMS REGISTERED WITH ESMA

MIFID/MIFIR	
Access to financial market infrastructure	UK firms do not have the same rights under MiFID as EU firms to become a member of or gain access to EU regulated markets, central counterparties and clearing and settlement systems.
Direct electronic access (DEA)	UK firms that are members of EU trading venues may not be permitted to provide DEA to their clients under MiFID.
Derivatives trading obligation (DTO)*	The EU and UK DTOs may inhibit the ability of UK firms to trade derivatives with EU counterparties where both DTOs apply and the EU and the UK do not recognise each other's trading venues as equivalent (or where the two DTOs differ in scope).
Share trading obligation (STO)*	The EU and UK STOs may inhibit the ability of UK firms to provide execution services in shares where both STOs apply and the EU and UK do not recognise each other's trading venues as equivalent (or where the two STOs differ in scope).
Systematic internalisers (SIs)	EU investment firms trading with a UK firm outside a trading venue may not be able to treat the UK firm as an SI satisfying their STO or their post-trade transparency obligations under MiFIR, even if the UK firm is subject to UK obligations similar to those of an EU SI under MiFIR. Similarly, a UK firm trading with an EU SI outside a trading venue may not be able to rely on the EU SI to satisfy its UK STO or its post-trade transparency obligation under MiFIR as it applies in the UK.
Transaction reporting	EU investment firms may not be able to rely on a UK firm to satisfy their transaction reporting obligation when they transmit orders to a UK firm, even if the UK firm is subject to EU transaction reporting obligations under MiFIR.
Pre- and post-trade transparency	EU and UK pre- and post-trade transparency rules will apply to different classes of financial instruments (or subject to different size thresholds, waivers or time limits). EU clients may be inhibited from trading with a UK firm where UK transparency rules would apply in a different way than if they were trading with an EU firm.
Operational issues	UK firms may also be directly subject to post-trade transparency and transaction reporting requirements in both the EU and the UK which may be operationally burdensome especially where the requirements differ. Where UK firms are members of an EU trading venue they may need to report information to the venue to enable the venue to satisfy its transaction reporting obligation even though the UK firm is reporting the transaction in the UK (or in the EU).

EMIR	
Derivatives clearing obligation*	Even if the EU and the UK recognise the same CCPs for clearing purposes, clearing requirements may still inhibit a UK firm trading with an EU counterparty if there are differences in the scope or timing of the application of EU and UK clearing requirements.
EMIR margin requirements*	In the absence of an EU or UK equivalence decision, margin requirements may inhibit trading of derivatives between a UK firm and an EU client or counterparty if the timing or thresholds for the phase-in of margin requirements differ from the EU or if other elements of the requirements differ (e.g., qualifying collateral).
Intra-group exemption*	In the absence of EU and UK equivalence decisions, EU or UK clearing or margin requirements may inhibit trading of derivatives between UK and EU affiliated firms.
Recognition of trading venues*	In the absence of an EU equivalence decision in respect of UK trading venues, EU financial and non-financial counterparties may be inhibited from trading on UK trading venues (via UK or EU firms) as they may need to recalculate their positions to determine whether they are subject to the clearing or margin obligations under EMIR.

PRUDENTIAL AND OTHER RULES	
Capital requirements under CRR (exposures to institutions)*	In the absence of an EU equivalence decision in respect of the UK, an EU institution subject to CRR may be subject to less favourable risk weighting or large exposure treatment for their exposures to UK firms. Similarly, in the absence of a UK equivalence decision in respect of the EU, UK firms subject to the 'onshored' CRR may be subject to less favourable risk weighting or large exposure treatment for their exposures to EU qualifying clients.
Solvency II	EU insurance companies may be subject to less favourable prudential treatment under Solvency II for exposures to UK firms than to EU banks or investment firms.
Capital requirements under IFR (K-CMG)	From June 2021, EU 'Class 2 investment firms' may not be able to use the more favourable K-CMG method of calculating capital requirements for certain exposures where clearing through a UK firm.
UCITS*	UCITS may be subject to restrictions on derivative and other transactions with UK firms that do not apply to transactions with EU banks or investment firms, unless they are recognised as equivalent under national rules.
Primary dealers	UK firms may no longer be able to act as primary dealers in member state government bonds.

* May be mitigated by an equivalence decision under the relevant legislation.

HOW IS REGISTRATION WITHDRAWN?

ESMA can withdraw a UK firm's registration where it has well-founded reasons to believe that the UK firm, in the course of EU activities, is acting in a manner clearly prejudicial to the interests of investors or the orderly functioning of markets or has seriously infringed the UK requirements on which the Commission based its equivalence decision.

Before ESMA can withdraw a UK firm's registration, it must first refer the matter to the relevant UK authorities to give them the opportunity to take appropriate measures to protect EU investors and the proper functioning of EU markets or to demonstrate to ESMA that the relevant UK firm does comply with the applicable UK requirements. Where such action is not taken, ESMA must, under the current regime, give the UK authorities at least 30 days' prior notice of its intention to withdraw the UK firm's registration. From June 2021, however, this requirement will be replaced by a requirement for ESMA to inform the UK authorities of its intention to withdraw the firm's registration in due course (i.e., there will no longer be a prescribed timeframe).

From June 2021, ESMA will be able, in some cases, temporarily to prohibit or restrict a UK firm from providing MiFID services to EU qualifying clients as an alternative to withdrawal of the firm's registration. ESMA will be required to take into account, when deciding on the action to be taken, the nature and seriousness of the risk posed to EU investors and to the proper functioning of EU markets. For this purpose, ESMA must consider the duration and frequency of the risk arising, whether the risk has revealed serious or systemic weakness in the firm's procedures, whether financial crime has been occasioned or facilitated or is otherwise attributable to the risk and whether the risk has arisen intentionally or negligently.

WHAT IF EQUIVALENCE IS WITHDRAWN?

The Commission can revoke an equivalence decision at any time. Generally, the Commission will publicly consult for four weeks before withdrawing a decision. In addition, where the Commission has previously withdrawn equivalence decisions, it has done so after lengthy discussions with the third countries concerned. The decision will be subject to confirmation by member state representatives through the European Securities Committee via the examination procedure. However, the examination procedure can be completed quickly and without prior public consultation or notice if the Commission considers that it is urgent to act.

If the Commission equivalence decision is withdrawn, UK firms will immediately lose their rights to provide services to qualifying EU clients under the regime, unless the withdrawal decision provides for transitional arrangements. UK firms can then continue to provide services in the EU in accordance with any national licensing regimes that permit this. However, UK firms may need to seek new national registrations, licences or exemptions under those regimes.

The Commission has broad discretion to withdraw an equivalence decision and has stated that it may consider withdrawing an equivalence decision based on developments affecting a third country's legal and supervisory regime, but also because of market developments (e.g., a significant increase in the exposure of EU markets to a third country). From June 2021, ESMA will be required to monitor the regulatory and supervisory developments, the enforcement practices and other relevant market developments in third countries for which equivalence decisions have been adopted in order to verify that the conditions on which the initial equivalence decision was taken continue to be fulfilled. ESMA will be required to submit an annual confidential report on its findings to the Commission, which in turn will need to make its own annual report to the European Parliament and the Council.

The UK government's published approach to the negotiations on the future UK-EU relationship states that the future agreement with the EU "could include appropriate consultation and structured processes for the withdrawal of equivalence findings, to facilitate the enduring confidence which underpins trade in financial services".[4] The directives for the negotiation of a new partnership with the UK adopted by the Council of the EU acknowledge that "transparency and appropriate consultation between the Union and the United Kingdom in relation to equivalence decisions is important, while preserving the Union's regulatory and supervisory autonomy".[5]

Whatever the outcome of the negotiations, UK firms that register with ESMA should consider whether they need contingency plans to address the risk of the withdrawal of equivalence, possibly on little or no notice. The PRA or FCA may also wish to evaluate whether these plans are sufficient to mitigate any potential resulting disruption to the UK firm's business model or adverse impact on the firm's clients.

4. Para 63, The Future Relationship with the EU: The UK's Approach to Negotiations (February 2020), here
5. Para 46, Directives for the negotiation of a new partnership with the United Kingdom of Great Britain and Northern Ireland (February 2020), here.

HOW ARE BRANCHES AFFECTED?

UK FIRMS WITH EU BRANCHES

A non-EU firm with a branch in an EU member state cannot generally rely on the branch's authorisation by that member state's competent authority to provide cross-border services to clients in other EU member states. The MiFID and CRD passports are only available to firms that are incorporated in and authorised in the EU.

However, if the Commission makes an equivalence decision under MiFIR with respect to the UK, UK firms with a branch established in a member state that has been authorised in accordance with Article 39 of MiFID will be able to provide MiFID services from that branch to qualifying clients in other EU member states. The services must be covered by the authorisation of the branch and the branch must give prior notice of its intention to provide those services to the competent authority in the EU member state where the branch is authorised.

The UK firm must comply with certain obligations under MiFID/MiFIR when providing those services through the branch and the branch will remain under the exclusive supervisory responsibility of the competent authorities of the EU member state in which it has been authorised.

From June 2021, those branches will be subject to enhanced annual reporting requirements including, where applicable, in respect of their cross-border services into other EU member states.

It is not necessary for the UK firm to register with ESMA in order to provide cross-border services to qualifying clients in other EU member states from an EU branch authorised under Article 39 of MiFID following a Commission equivalence decision. If the Commission made a decision before the end of the transition period, this may provide UK firms with EU branches the option of providing services from those branches to qualifying clients in other EU member states from the end of the transition period even if there are delays in ESMA registering the firm to provide cross-border services to those clients from outside the EU. However, not all EU member states authorise branches of non-EU firms in accordance with that Article.

EU FIRMS WITH UK BRANCHES

EU firms will not be able to rely on the MiFIR regime to provide services to EU clients from their UK branches as the regime is only available to firms whose head office is outside the EU.

OTHER NON-UK FIRMS WITH UK BRANCHES

Other non-UK firms with UK branches will not be able to rely on a Commission equivalence decision in respect of the UK in order to provide services to EU clients from their UK branches. The regime is only available to firms that have their head office and are authorised in the jurisdiction which is the subject of the relevant equivalence decision.

WHAT IF UK FIRMS DO NOT REGISTER?

For three years after the adoption of an equivalence decision with respect to the UK, UK firms can choose to continue to provide cross-border services to EU qualifying clients in reliance on available national licensing regimes permitting that business. After that (at least in respect of those services covered by the decision), UK firms that have not registered with ESMA will only be able to provide cross-border services to EU qualifying clients at the 'own exclusive initiative' of the client.

ESMA has interpreted this concept relatively narrowly,[6] although the changes made by IFR to the regime suggest that services provided by UK firms to group entities in the EU will be considered to be provided at the exclusive own initiative of the EU group company.

6. Section 13, ESMA, Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics (February 2020), here.

WILL THE UK ACTIVATE ITS EQUIVALENCE REGIME?

At the end of the transition period, EU firms will lose their ability to provide cross-border MiFID services to UK clients under a MiFID or CRD passport. However, even if HM Treasury takes no action to activate the third-country regime in the 'onshored' MiFIR, the impact of this change will be mitigated by the UK's temporary permission regime (TPR) and financial services contracts regime (FSCR)[7] and, for firms not operating through a branch in the UK, by the general exemptions and exclusions under the UK Financial Services and Markets Act 2000 (FSMA).

EU firms that opt into the TPR before the end of the transition period will be able to continue operating in the UK within the scope of their current passports for a limited period (expected to be no more than three years) after the end of the transition period while seeking full UK authorisation (which will generally require the firm to have a UK branch). EU firms that do not opt into the TPR or which exit the TPR without obtaining full UK authorisation will benefit from the FSCR which will allow them five years to wind-down existing non-insurance contracts where the servicing of those contracts would require authorisation in the UK (but not to enter into new business).

In any event, after the end of the transition period, EU firms that do not have a UK branch should generally be able to provide MiFID services to most if not all UK qualifying clients without authorisation in the UK under the general exemptions or exclusions under FSMA. Therefore, EU firms may choose not to enter the TPR or to exit the TPR without seeking authorisation in the UK and to rely on those exemptions or exclusions instead.

In outline, FSMA regulates non-UK firms seeking to conduct cross-border business with UK clients and counterparties, firstly, by prohibiting them communicating 'financial promotions' that are capable of having an effect in the UK unless those communications are approved by a UK authorised person and, secondly, by prohibiting them from carrying on regulated activities in the UK without authorisation. However, these prohibitions are subject to important exemptions and exclusions.

In particular, the prohibition on the communication of financial promotions is subject to exemptions that allow the communication of financial promotions to UK authorised persons and other 'investment professionals' and, in the case of securities and derivatives business, 'high net worth companies, unincorporated associations, etc.'[8]

7. Parts 3 and 6 of the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018.
8. Articles 19 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

These exemptions should allow non-EU firms to communicate with most if not all UK qualifying clients without contravening the restriction on financial promotion.

In addition, the prohibition on the carrying on of regulated activities in the UK is subject to the 'overseas persons' exclusion. This allows firms without a permanent place of business in the UK to provide cross-border MiFID services to UK clients and counterparties without authorisation in the UK where the services involve transactions with or through UK authorised persons or where the services arise from a 'legitimate approach', i.e., an approach that is unsolicited or that does not contravene the restriction on financial promotions.[9] The exemptions referred to above should allow non-EU firms to communicate with most if not all UK qualifying clients without contravening the restriction on financial promotion, thus allowing those clients to be the subject of a 'legitimate approach' for the purposes of the exclusion.

Non-UK firms can rely on these exemptions and exclusions without registration with the FCA and without ongoing information, conduct, record-keeping, transparency, transaction reporting and trading obligation requirements comparable to those that apply (or may be applied) to firms registered under the MiFIR third-country regime.

As a result, it is likely to be less important to EU firms whether HM Treasury makes an equivalence decision in respect of the EU so as to activate the third-country regime under the 'onshored' MiFIR. If it did, EU firms could rely on that regime to provide cross-border MiFID services to UK qualifying clients subject to registration with the FCA (and pending their registration with the FCA they could rely on the TPR or the exemptions and exclusions under FSMA). They would also be subject to similar ongoing obligations to those applying to UK firms providing such services to EU qualifying clients under the MiFIR third-country regime, although it is uncertain whether the UK will adopt rules for non-UK firms corresponding to the EU rules applicable to non-EU firms under IFR from June 2021.

If HM Treasury makes an equivalence decision in respect of the EU under the 'onshored' MiFIR, EU firms will cease to be able to rely on the 'overseas persons exclusion' after three years. This will result in EU firms being subject to registration and ongoing requirements when providing services to UK qualifying clients that do not apply to non-EU firms.

On the other hand, some EU firms may prefer the clarity provided by registration with the FCA under 'onshored' MiFIR even with its additional requirements. Registration would give the FCA greater visibility of and control over EU firms providing MiFID services to UK qualifying clients and the application of less favourable treatment to EU firms may be justified by virtue of the 'prudential carve-out' under GATS.[10] This allows WTO members to take measures that would otherwise conflict with their obligations under GATS where they do so "for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system" (otherwise than as a means of avoiding the member's obligations under GATS).

9. Article 72 of the Financial Services and Markets Act 2000 (Regulated Activities Order 2001.

10. Para 2(a) Annex on Financial Services of the GATS, here.

However, imposing these registration and ongoing requirements on EU firms may also inhibit the ability of UK firms to provide MiFID services to EU firms. Some EU firms may be unwilling to register with the FCA and be uncertain as to whether they would be regarded as providing services at the 'own exclusive initiative' of the UK firm, meaning that they prefer to transact with other EU firms instead of UK firms.

In any event, other UK - or EU or member state - rules may apply in ways that inhibit the ability of EU firms to provide cross-border services to UK qualifying clients. For example, the EMIR clearing obligation may apply to OTC derivatives entered into by EU firms with UK pension schemes. In addition, some, but not all of, the inhibitions described in above affecting UK firms' business with EU qualifying clients (such as the DTO or STO) may also affect the ability of EU firms to conduct business with UK qualifying clients in a similar way.

ANNEX

INFORMATION REQUIRED FOR REGISTRATION WITH AND REPORTING TO ESMA

SUMMARY OF REQUIRED INFORMATION	REGISTRATION		REPORTING	
	CURRENT REGIME	AMENDED REGIME	CURRENT REGIME (AD HOC REPORTING)	AMENDED REGIME (ANNUAL REPORTING)
Identity of the firm	✓	✓	✓*	✓*
Contact person at firm	✓	✓	✓*	✓
Third-country supervisory authorities	✓	✓	✗	✓*
MiFID services covered by third-country authorisation (declaration by competent authority)	✓	✓	✓*	✓*
MiFID services to be provided in the EU	✓	✓†	✓*	✗
How EU activities will contribute to the strategy of the firm	✗	✓	✗	✓*
Governance arrangements	✗	✓	✗	✓* ‡
Marketing strategy for EU	✗	✓	✗	✓
Investor protection arrangements	✗	✓	✗	✗
Outsourcing arrangements (with focus on EU operations)	✗	✓	✗	✓*
Arrangements (including IT) for algorithmic trading, high frequency trading and for direct electronic access	✗	✓	✗	✓*
Structure, organisation and monitoring of compliance function	✗	✓	✗	✓*
Structure, organisation and monitoring of internal audit function	✗	✓	✗	✓*
Structure, organisation and monitoring of risk management function	✗	✓	✗	✓*
Arrangements and procedures for annual reporting	✗	✓	✗	✗
For each member state, MiFID services provided, number of clients / counterparties and total net turnover	✗	✗	✗	✓ ‡
Total number of clients / counterparties globally	✗	✗	✗	✓
Firms dealing on own account - exposure to EU counterparties (total and per member state)	✗	✗	✗	✓ ‡
Firms providing underwriting or placing services - total value of instruments originating from EU counterparties underwritten or placed on firm commitment basis (total and per member state)	✗	✗	✗	✓ ‡

SUMMARY OF REQUIRED INFORMATION	REGISTRATION		REPORTING	
	CURRENT REGIME	AMENDED REGIME	CURRENT REGIME (AD HOC REPORTING)	AMENDED REGIME (ANNUAL REPORTING)
Firms providing portfolio management – value of assets under management for EU clients (total and per member state)	✗	✗	✗	✓ ‡
Firms providing investment advice – value of assets in relation to which services have been provided (total and per member state)	✗	✗	✗	✓ ‡
Firms providing custody services or holding client money – value of assets (including cash) held for EU clients (total and per member state)	✗	✗	✗	✓ ‡
Complaints received by the firm	✗	✗	✗	✓
Activities of the compliance function, incl. changes to investor protection arrangements (with focus on EU operations)	✗	✗	✗	✓ ‡
Activities of the internal audit function (with focus on EU operations)	✗	✗	✗	✓
Activities of the risk management function (with focus on EU operations)	✗	✗	✗	✓
Other relevant information	✗	✓	✗	✓ ‡

* Changes or material changes to registration information only.

† Information requirement is more extensive under amended regime (e.g., expected numbers of clients / counterparties and total net turnover).

‡ Information required by Article 46(6a) MiFIR (amended).

Information on the current regime is based on Articles 1 and 2 of Commission Delegated Regulation (EU) 2016/2022. Information on the amended registration and reporting regime is based on Article 46(6a) MiFIR and ESMA's consultation paper, Draft technical standards on the provision of investment services and activities in the Union by third-country firms under MiFID II and MiFIR (January 2020) and is subject to the final technical standards.

ACKNOWLEDGEMENTS AND CONTACTS

This briefing was prepared by UK Finance with support from Clifford Chance LLP. This briefing is intended to provide general information only and is not intended to be comprehensive or to provide legal, regulatory, financial or other advice to any person. Information contained in this briefing based on public sources has been assumed to be reliable and no representation or undertaking is made or given as to the accuracy, completeness or reliability of this report or the information or views contained in this briefing. Neither UK Finance or Clifford Chance LLP nor any of their respective members, officers, employees or agents shall have any liability to any person arising from or in connection with any use of this report or any information or views contained in this briefing.

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