Brexit Alert

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Light at the End of the (Channel) Tunnel

MiFID II's Passport for "Third Countries" and the Possibility of Continued Access to the EU Market for UK Firms

The decision to hold a referendum as to whether the United Kingdom (UK) should remain a member of the European Union (EU) introduced the term "Brexit" into the global political lexicon. Now that the UK has voted to leave the EU, the term has spawned new variations: will the UK's departure be a "soft-Brexit" or a "hard-Brexit"?

Those advocating a soft-Brexit assume that the UK will be able to negotiate continued access to the EU's single market in financial services, perhaps by agreeing to join the European Economic Area (EEA) (members of which accept certain laws of the EU, including in relation to financial services, in return for access to the single market).

If this turns out not to be possible, perhaps because EEA membership is simply not on offer or because the cost of becoming a member of the EEA is politically unacceptable (EEA membership entails the free movement of labour between EU and EEA member states, making a contribution to the EU budget and accepting laws over which the EEA member state has little say), the UK will have to contemplate the possibility of a "hard-Brexit," in which it no longer has automatic access to the single market. Press coverage has assumed that UK financial institutions that currently rely on their EU "passports" to provide financial services to clients in the remaining EU Member States on a cross-border basis would have to relocate to a remaining member state.

However, revisions to the EU's Markets in Financial Instruments Directive (MiFID) that take the form of an EU regulation ("MiFIR") and an EU directive ("MiFID II") may provide an avenue for these firms to continue providing services into the EU on a cross-border basis as much as before, even in a hard-Brexit scenario. Although it is impossible to predict exactly how and when the UK will leave the EU, there is no realistic prospect of it having left before MiFIR and MiFID II are implemented into the national law of the UK. (Ironically, after months of speculation and delay, the European Parliament finally confirmed on the day of the referendum that MiFIR and MiFID II must be implemented by Member States by January 2018).

On leaving the EU, the UK will become what is known as a "third country" under MiFID (the term used for any country that is not an EU Member State), with financial institutions domiciled in the UK becoming "third-country firms." Whilst third-country firms are unable to benefit from the current MiFID passporting regime, this will change under MiFIR and MiFID II.

Under Article 46 of MiFIR, third-country firms that are registered with the European Securities and Markets Authority (ESMA) will be able to provide investment services or perform investment activities in respect of eligible counterparties and professional clients on a cross-border basis throughout the EU (the “third-country firm cross-border services passport”).

However, registration can only be granted once the conditions below have been satisfied:

A. The firm is authorised in the jurisdiction where its head office is established to provide those investment services or activities that it intends to provide within the EU, and it is subject to effective supervision and enforcement ensuring full compliance with the requirements applicable in that third country.

B. The EU Commission has determined that the legal and supervisory arrangements of that third country ensure that firms authorised in that third country comply with legally binding prudential and business conduct requirements that have “equivalent effect” to the requirements set out in MiFID II and MiFIR.

Under Article 47 MiFIR, the prudential and business conduct framework of a third country will be considered to have “equivalent effect” where that framework fulfills all of the following conditions:

- Firms providing investment services and activities in that third country are subject to authorisation and to effective supervision and enforcement on an ongoing basis.
- Such firms are subject to sufficient capital requirements and appropriate requirements applicable to shareholders and members of their management body.
- Such firms are subject to adequate organisational requirements in the area of internal control functions.
- Such firms are subject to appropriate conduct of business rules.
- It ensures market transparency and integrity by preventing market abuse in the form of insider dealing and market manipulation.

C. Cooperation arrangements have been established between the relevant regulator of the third country and ESMA concerning:

- exchange of information (including access to all information regarding non-EU firms authorised in third countries that is requested by ESMA)
- the mechanism for prompt notification to ESMA where a third-country regulator deems that a third-country firm that is under its supervision and is registered with ESMA infringes the conditions of its authorisation or other law to which it is obliged to adhere
- procedures concerning the coordination of supervisory activities, including, where appropriate, on-site inspections.

The obvious fly in this particular ointment is that the decision to recognise the UK as having financial regulation with “equivalent effect” to that in the EU is entirely within the gift of the Commission. However, at the point of departure (assuming that it is after January 2018), the law in the UK will not just be equivalent to that in the EU; it will, in fact, be **exactly the same**.

The only reason, then, for the Commission to refuse that equivalence determination will be political. Of course, the Commission may well have many political reasons to refuse to make the determination—but, unless there is to be a complete breakdown in the relationship between the UK and the EU (which would be in no one’s interests), there is reason to believe that pragmatism will prevail.

Contact Information

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