Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit

by

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This article considers the recent evolution of the EU's third country regime for capital market access in light of Brexit, the important series of legislative reforms adopted in March 2019 as the 2014-2019 European Parliament/Commission term closed, and the emergence of the European Securities and Markets Authority (ESMA) as a material technocratic influence. The article suggests that while the capital market third country regime is changing (with Brexit a key but not exclusive driver of change), it is not being radically recast, although it is tightening. The regime remains broadly based on the more-or-less liberal 'deference' model which has long characterised EU third-country financial services policy. But it is becoming increasingly 'on-shored' by means of the direct application of EU rules and by ESMA's oversight/supervision of certain third country actors. The significantly more restrictive approach being taken to third country central clearing counterparties is a marked development, but here the political and economic context is distinct. The implications of the overall shift towards a more 'on-shore', centralised, and potentially restrictive access regime are considered, and a modest reform prescription is offered.

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1. Introduction

The UK's June 2016 decision to leave the EU has generated an extensive policy debate and a burgeoning scholarly literature on the implications for EU capital market regulation. The future of the Capital Markets Union (CMU) agenda in the absence of the EU's largest capital market, whether or not EU capital market regulation will become more dirigiste,[1] and how Member States' interests will be reshuffled in this key and frequently highly-contested area of EU regulatory policy are among the 'big ticket' issues to have been widely discussed.[2] Attention has most often focused, however, on the EU's third country capital-market-access regime, how it will accommodate the UK as a systemically-significant, off-shore, third country capital market, and whether the exigencies of Brexit will drive wider change to the third country regime.[3] This heightened focus on market access arrangements is not unique to the EU. IOSCO is currently examining market access arrangements globally as the evidence of increased capital market fragmentation in the wake of the crisis-era reforms ac-

1 As recently suggested by the Financial Times: Editorial, "UK Politicians must set out the Future for Finance", Financial Times, 18 November 2019.

2 From an extensive legal/political science literature see e.g.: *Jakob Schemmel*, "Regulating European Financial Markets between Crisis and Brexit", Journal of Financial Regulation and Compliance 2019, DOI: 10.1108/JFRC-04-2018-0057; *David Howarth/Lucia Quaglia*, "Brexit and the Battle for Financial Services", Journal of European Public Policy 25 (2018), 1118; *David Howarth/Lucia Quaglia*, "Brexit and the Single European Financial Market", Journal of Common Market Studies 55 (2018), 149; *Scott James/Lucia Quaglia,* "The Brexit Negotiations and Financial Services: A Two-Level Game Analysis", The Political Quarterly 89 (2018), 560; *Niamh Moloney*, "Brexit and Financial Services: (yet) another restructuring of EU institutional governance for financial services", Common Market Law Review 55 (2018), 175; *Georg Ringe*, "The Politics of Capital Markets Union", ECGI Law Working Paper No 469/2019; and *Niamh Moloney*, "Bending to Uniformity: EU Financial Regulation with and without the UK", Fordham International Law Journal 40 (2017), 1335.

3 *Elizabeth Howell*, "Post-'Brexit' Financial Governance: Which Dispute Settlement Framework should be Utilised", Modern Law Review 23 (2020), 128; *Kern Alexander*, The UK's Third Country Status Following Brexit: Post-Brexit models, third country equivalence and Switzerland, in: *Kern Alexander/Catherine Barnard/ Eilís Ferran/Andrew Lang/Niamh Moloney*, Brexit and Financial Services – Law and Policy, 2018, p. 115 *et seq*; *Henning Berger/Nikolai Badenhoop*, "Financial Services and Brexit: Navigating Towards Future Market Access", European Business Organisation Law Review 19 (2018), 679; *Niamh Moloney*, Capital Markets Union, Third Countries, and Equivalence: Law, Markets and Brexit, in: *Danny Busch/Emilios Avgouleas/Guido Ferrarini* (eds.), Capital Markets Union in Europe, 2018, p. 97 *et seq*; John Armour, "Brexit and Financial Services", Oxford Journal of Economic Policy 33 (2017), (Supp 1), S54; and *Eilís Ferran*, "The UK as a Third Country in EU Financial Services Regulation", Journal of Financial Regulation 3 (2017), 40.

cumulates.[4] But while a host of influences and interests drive market access discussions in the EU,[5] it is clear that the 2016 Brexit decision, and the related implications for the EU's pivotal CMU agenda, can be strongly associated with the EU's recent focus on its previously somewhat arcane and often overlooked third country arrangements. Since 2016, the EU's future approach to the UK as a third country has become clearer but in addition several measures reforming the third country regime have been adopted under the umbrella of the CMU agenda. These developments require consideration and contextualisation.

Alongside, there have been material technocratic developments related to but independent of Brexit. Specifically, the European Securities and Markets Authority (ESMA) has become actively engaged with the third country regime, and an EU appetite for conferring additional powers on ESMA in this area has emerged. The nature of ESMA's growing influence on the third country regime accordingly needs to be unpacked and any challenges exposed. ESMA is a technocratic agency and its powers are delegated, but the third country regime is currently of acutely high political salience: ESMA may accordingly be exposed to legitimacy risks,[6] even allowing for the well-charted fuzziness of the border between political (prohibited) and technocratic (delegated) agency action.[7] More generally, given the burgeoning evidence that ESMA has become a highly dynamic, purposeful, and entrepreneurial technocratic actor since its 2011 establishment,[8] its approach to the third country regime is something of a bellwether for ESMA's future evolution more generally, and for any related effectiveness or legitimacy strains.

This discussion therefore seeks to contribute to the literature on the EU's third country regime at a distinct political and technocratic inflection point by identifying emerging trends and their implications. It reflects on the recent legislative reforms and their political/institutional context; and it considers the impli-

4 *IOSCO*, Market Fragmentation and Cross-border Regulation, 2019.

5 For a pre-Brexit discussion see *Lucia Quaglia*, "The Politics of 'Third Country Equivalence' in Post-Crisis Financial Services Regulation in The European Union", Western European Politics 38 (2015), 167 and *Andreas Dür*, "Fortress Europe or Open Door Europe? The External Impact of the EU's Single Market in Financial Services", Journal of European Public Policy 18 (2011), 619.

6 On the political importance of market access decisions see *Eric Helleiner/Stefano Pagliari*, "The End of an Era in International Financial Regulation? A Post-Crisis Research Agenda", International Organization 65 (2011), 169.

7 For two classic accounts see *Mark Thatcher/Alec Stone Sweet,* "Theory and Practice of Delegation to Non-Majoritarian Institutions", *Western European Politics* 25 (2002), 1 and *Giandomenico Majone*, Regulating Europe, 1996.

8 For analysis see: *Niamh Moloney,* The Age of ESMA – Governing EU Financial Markets, 2018. Elements of section two of this discussion are drawn from chapter six.

cations of ESMA's strengthening technocratic powers in an area that is likely to become increasingly politically-contested.

Section Two outlines the main features of the EU's third country regime for capital markets and of ESMA's technocratic role. Section Three considers the Brexit-era legislative reform process, its context, and the implications. Section Four offers a modest reform prescription. Section Five concludes.

2. *The Third Country Regime: A Helicopter View*

2.1 *The Equivalence Regime*

The EU, in common with all major financial markets internationally, controls access by non-domestic/non-EU (third country) actors to its financial market. Most usually, an EU-level access regime is not available, and third country actors must instead engage bilaterally with individual Member States, being accordingly 'locked within' such Member States' markets and not benefiting from single market access. There are, however, a number of single market access regimes for discrete segments of the EU financial market. The rules which govern such access by third country actors are scattered in legislative silos across sectoral EU financial market legislation. Usually these access rules require some form of 'equivalence' determination by the Commission as to the extent of the alignment between the EU's and the third country's rules and supervisory arrangements.[9] In addition, reciprocal obligations, third country compliance with different supervisory and taxation cooperation requirements, and, most recently, third country compliance with global anti-money laundering and terrorism financing standards also apply. The equivalence determination, however, is at the core of the EU's third country regime for financial services and markets. Some 40 or so legislative provisions cover the different third country arrangements for financial services/markets and over 280 equivalence decisions have been taken in respect of more than 30 third countries.[10]

The required equivalence determination by the Commission is crucial to third country access. In very broad terms, where a particular capital market segment has an EU third country regime in place, and where the relevant third country regulatory/supervisory regime is deemed by the Commission to be 'equivalent' to the relevant sectoral EU regime (different legislative criteria for assessing equivalence apply and the Commission's decision is discretionary), a

9 For an institutional perspective see: *European Parliament,* Briefing, Third Country Equivalence in EU Banking Legislation, 9th December 2016.

10 *Commission*, Equivalence in the area of Financial Services (COM(2019)349).

third-country-regulated actor can access the EU capital market segment in question on the basis of those third country rules.[11] Registration/recognition and/or supervisory coordination and monitoring requirements may also apply. The EU capital market access regime can thus be broadly characterised as a 'deference' model: once the threshold equivalence assessment is successful, the EU does not usually require 'on-shore' (in the EU) supervision of relevant third country actors or apply its rules directly.[12]

The EU's third country regime for capital markets, reflecting the multiple and shifting interests which have shaped it, is, as is well known, partial and silo-ed. But at its core are the MiFID II/MiFIR, EMIR, and rating agency third country regimes. In all these cases, third country access to the EU depends on a prior positive equivalence decision by the Commission; the determinants of equivalence in each case are specified in the relevant legislation. Also in all these cases, ESMA is engaged to greater or less extents.

Since January 2018, MiFID II/MiFIR[13] permits the provision of third country investment services to EU wholesale market participants, without a requirement for an EU presence and on a cross-border services basis, once a positive Commission equivalence decision is in place. Third country access is also contingent on the regulated actor being 'registered' with ESMA. ESMA registration requires that the Commission equivalence decision is in place; the firm is authorised in its home jurisdiction and subject to effective supervision and enforcement there; and related supervisory coordination arrangements with the third country supervisor have been established (MiFIR, Article 46). ESMA is not empowered to supervise these registered third country firms, but it can withdraw a registration decision.[14] Third country access has yet to be granted under MiFID II/MiFIR.

11 The EU's third country rules also have a significant internal dimension, clear from the enhanced capital requirements which apply to EU banks' third country loan assets that do not originate in an 'equivalent' third country, the rules which require that certain share and derivative trades by EU counterparties are carried out on EU venues or 'equivalent' third country venues, and the obligation that certain derivatives are cleared on CCPs in the EU or in 'equivalent' third countries.

12 The deference model is not common internationally but has been associated in particular with the short-lived embrace by the US, immediately prior to the financial crisis, of a 'substituted compliance' access model for certain financial sectors and for qualifying jurisdictions: *Howell Jackson*, "Substituted Compliance: the Emergent Challenges and Evolution of a New Regulatory Paradigm", Journal of Financial Regulation 1 (2015), 169.

13 Directive 2014/65/EU [2014] OJ L173/349 and Regulation (EU) No 600/2014 [2014] OJ L173/84.

14 The conditions governing ESMA's withdrawal of registration (MiFIR, Art. 49) relate to ESMA having 'well-founded reasons based on documented evidence' that the firm, in relation to its EU activities, is acting in a manner clearly prejudicial to the interests of

The EMIR regime[15] contains several third-country-access-related provisions, but at its core is the access regime for third country central clearing counterparties (CCPs). ESMA may 'recognise' a third country CCP, which can then provide services in the EU, when a series of conditions are met (EMIR, Article 25(2)). Central to the ESMA recognition regime is the adoption of a prior positive equivalence decision by the Commission. The CCP in question must also be authorised in the relevant third country and, in ESMA's judgment, be subject to effective supervision and enforcement, ensuring full compliance with the third country's prudential requirements. Appropriate co-operation arrangements must also have been established between ESMA and the relevant third country supervisor. As under MiFIR, ESMA is not empowered to supervise 'recognised' CCPs but engages in ongoing review and monitoring of the recognition conditions. ESMA has, however, recently claimed a form of supervisory oversight in that in practice it monitors third country CCPs for stability and other risks they may pose to the EU financial market, in accordance with its general ESMA Regulation mandate to support financial stability.[16] ESMA recognised a first group of 11 CCPs in 2016 (following the related Commission equivalence decisions) and has continued to recognise CCPs as subsequent Commission equivalence decisions are made.[17]

A similar regime applies to third country trade repositories under EMIR. A trade repository established in a third country may provide services and activities to entities established in the EU only after it has been 'recognised' by ESMA (EMIR, Article 77(1)). ESMA recognition is conditional on the trade repository submitting to ESMA all the necessary information, including at least

investors or the orderly functioning of markets, or that the firm has seriously infringed provisions applicable to it in the third country and based on which the equivalence decision was made.

15 Regulation (EU) No 648/2012 [2012] OJ 201/1.

16 *ESMA*, ESMA's Supervision of Credit Rating Agencies, Trade Repositories and Monitoring of Third Country Central Counterparties. 2016 Annual Report and 2017 Work Programme, 2017, pp. 60–65.

17 ESMA has recognised ten additional third country CCPs and continues to assess applications: *ESMA*, ESMA's Supervision of Credit Rating Agencies, Trade Repositories and Monitoring of Third Country Central Counterparties. 2018 Annual Report and 2019 Work Programme, 2019, pp. 58–59. ESMA also prepared temporary recognition decisions for three UK CCPs as a mitigant against a no-deal Brexit, following the Commission's adoption of a related exceptional and temporary equivalence measure (noted below). Following the October 2019 agreement between the UK and the EU on a Withdrawal Agreement, and the expected (at the time of writing) withdrawal of the UK from the EU on 31 January 2020, this immediate risk has been removed, although concerns remain as to the potential for a December 2020 'cliff edge' if the UK and EU fail to agree a trade deal.

the information necessary to verify that the trade repository is authorised and subject to effective supervision in a third country which has been recognised by the Commission as being equivalent in accordance with EMIR, and appropriate co-operation arrangements being in place (Articles 77(2) and 75(3)). As yet, no third country trade repository has applied for ESMA recognition.

ESMA is also pivotal to the two-pronged third country regime which applies under EU rating agency legislation (the Consolidated Credit Rating Agency Regulation (CCRAR)[18]). First, under the legislation's 'endorsement regime', where a third country rating agency forms part of a group which includes an EU rating agency, its ratings can be used for regulatory purposes in the EU where the rating is 'endorsed' by the EU rating agency (CCRAR, Article 4). A series of conditions which are policed by ESMA (and which include an equivalence-like 'as stringent as the CCRAR' assessment by ESMA of the relevant third country rules) apply to the endorsement process. These conditions in effect allow ESMA to supervise the third country rating agency by supervising how the 'endorsing EU rating agency' complies with its endorsement obligations.[19] Second, under the CCRAR 'equivalence/certification regime', a third country rating agency which is not associated with an EU rating agency may issue ratings which can be used for regulatory purpose in the EU, but the rating agency must be 'certified' by ESMA (CCRAR, Article 5). For such certification, the third country rating agency must be authorised or registered and subject to supervision in the third country; the Commission must have adopted a positive equivalence decision relating to the legal and supervisory framework of the third country; and co-operation arrangements between ESMA and the third country authority must be in place (Article 5(1)). A certified rating agency is supervised by ESMA to ensure it complies with the conditions of its certification. While a number of third country rating agencies have been endorsed, only four third country rating agencies have been certified.[20]

A host of other sectoral capital market legislative measures conain different types of third country/equivalence arrangements. For example, the 2017 Prospectus Regulation permits the use of third country prospectuses to meet EU disclosure requirement once an equivalence assessment is passed and supervi-

18 The EU's rating agency regime is split across four legislative measures. References here relate to the Commission's informal consolidation of the texts in the Consolidated Credit Rating Agency Regulation (CCRAR) (ELI: http://data.europa.eu/eli/reg/2009/1060/2015-06-21).

19 ESMA has emphasised its supervisory and enforcement jurisdiction over 'endorsing' EU rating agencies: *ESMA*, Final Report. Technical Advice on CRA Regulatory Equivalence – CRA 3 Update, 2017, pp. 7–8.

20 The current list is available via https://www.esma.europa.eu/supervision/credit-rating-agencies/risk.

sory cooperation arrangements are in place;[21] the 2016 Benchmark Regulation contains an equivalence/access regime for third country benchmark administrators which is based on recognition by national competent authorities (NCAs) but which also requires ESMA to enter into cooperation arrangements (under the 2019 ESA Regulation reforms, however, ESMA will be responsible for recognising such administrators from 2022);[22] and the 2014 Central Securities Depositaries Regulation deploys an ESMA 'recognition' mechanism for third country depositaries which requires a Commission equivalence decision.[23]

2.2 *The Institutional Setting, Technocracy and ESMA*

In practice, the Commission controls these different third country regimes, once they are adopted by the co-legislators, in that it adopts the administrative equivalence decisions which open (or close) third country access.[24] In its February 2017 Report on Equivalence[25] the Commission asserted its institutional pre-eminence, highlighting that a Commission equivalence decision is unilateral and discretionary and can be changed or withdrawn as necessary 'at any moment.'[26] It is also clear that, while the Commission usually calls on ESMA's technical expertise when making equivalence decisions, in areas of acute political salience the Commission retains the equivalence process inhouse. For example, it managed the highly sensitive and market-critical 2017 US equivalence determination relating to the MiFIR 'derivatives trading obligation' (which requires that certain classes of derivative be traded on an EU trading venue or on a trading venue operating in an equivalent regulatory regime). The Commission's finding that certain trading venues supervised by the US Commodities and Futures Trading Commission (CFTC) did meet the equivalence criteria followed negotiations with the CFTC and the adoption by the Commission and the CFTC of a 'general approach' to govern the application of the respective EU and US derivatives trading obligations to EU and US

21 Regulation (EU) No 2017/1129 [2017] OJ L168/12, Arts. 29–30.

22 Regulation (EU) No 2016/1011 [2016] OJ L171/1, Arts. 30–33.

23 Regulation (EU) No 909/2014 [2014] OJ L257/1, Art. 25.

24 The Commission is typically conferred with the power to initiate the equivalence process and to adopt an equivalence decision. Commission decision-making on equivalence (decisions take the form of Implementing Acts) is overseen by a comitology committee which includes Member State representatives, but it is procedurally difficult to over-ride the Commission.

25 *Commission*, EU Equivalence Decisions in Financial Services Policy: An Assessment (SWD(2017)102).

26 *European Parliament*, (fn. 9).

trading venues.[27] ESMA was not directly involved in this process, although it had earlier acknowledged market concern as to the potential disruption that failure to adopt an equivalence decision could wreak.[28]

Nonetheless, it is clear that since its 2011 establishment ESMA has emerged as pivotal player in the equivalence process. ESMA is charged under its founding Regulation with assisting the Commission on equivalence decisions[29] and in practice is almost always called on by the Commission for technical advice. In relation to the rating agency certification process, for example, the Commission's initial related equivalence decisions were closely based on ESMA's earlier technical assessments.[30] The Commission's first set of EMIR CCP equivalence decisions also broadly reflected ESMA's overall approach, albeit that ESMA's advice was potentially politically sensitive in that in several cases it made a finding of conditional equivalence, advising the Commission that it could consider the relevant regime to be equivalent where CCPs ensured their internal rules and procedures reflected certain EMIR provisions. The Commission broadly followed ESMA's approach, although it did not specify in its equivalence decisions the specific adjustments that ESMA recommended be made by CCPs, save as regards US CCPs;[31] the US CCP negotiations were also conducted at a higher political level than those relating to other jurisdictions.[32] More recently, the extent of ESMA's influence on the equivalence process is clear from its 2017 advice to the Commission that certain jurisdictions were no longer equivalent as regards rating agency regulation;[33] the Commission has since rescinded several of its CCRAR equivalence decisions, as noted below. It is also becoming clear that the equivalence process affords ESMA significant opportunities to strengthen its credibility and so its ability to exert influence on the regime, given the technical competence, astute international financial diplomacy, and deft institutional politicking which these assessments require.[34] Similarly, the requirement for third countries to enter into cooperation agreements, usually a precondition of equivalence decisions, has given ESMA a platform from which it can build relationships internationally and also deepen

27 Commission Implementing Decision 2017/2238 [2017] OJ L320/11.

28 *ESMA*, Final Report – Draft Regulatory Technical Standards on the Trading Obligation for Derivatives under MiFIR (2017).

29 Regulation (EU) No 1095/2010 [2010] OJ L331/84), Art. 33.

30 ESMA/2012/259 and ESMA/2013/262.

31 Commission Implementing Decision 2016/377 [2016] OJ L70/32.

32 The CCP equivalence discussions with the US were difficult and required high level EU/US political engagement: *House of Lords, EU Committee,* 9th Report of Session 2016-2017, Brexit: Financial services (2016), para. 49.

33 ESMA CRA 3 Update 2017 (fn. 19).

34 ESMA's technical advice on the equivalence of the Australian CCP regime, e.g., involved close engagement with the relevant Australian regulators (ESMA/2013/BS/1159).

its intelligence on international financial governance, either by supporting NCAs in adopting such agreements, or by adopting such agreements independently.[35]

The extent of ESMA's related gatekeeper role is also becoming clear. Thus far, gatekeeper functions have been conferred on ESMA only in relation to the 'registration' of firms under MiFIR (on which there is as yet no evidence); the 'certification' of rating agencies under the rating agency regime; and the 'recognition' of third country CCPs and trade repositories under EMIR. Of these three, there is most experience with CCP recognition. The initial 2016-2017 experience with ESMA's recognition of 11 CCPs certainly evidences an emerging ESMA determination to maximise its ability to exercise some form of oversight over third country CCPs, despite the limitations of the recognition process which does not at present grant ESMA direct supervisory powers.[36] Under EMIR, ESMA is required to monitor ongoing compliance by recognised third country CCPs with their recognition conditions, including any related conditions on the underlying equivalence finding,[37] but it is not empowered to supervise them directly. Nonetheless, from the outset ESMA claimed a financial stability mandate to monitor CCPs' recognition conditions against the potential risks which third country CCPs posed to the EU market; and it has also developed bespoke data collection channels and risk indicators for monitoring potential risks to the EU market.[38] Further, in the wake of the Brexit decision, ESMA used its third country CCP experience to call for more extensive powers over third country CCPs and other third country actors[39] – to some effect, given the EMIR 2.2 reforms to the CCP regime subsequently adopted in 2019, noted below.

35 ESMA's first set of CCP recognition decisions was accompanied by ESMA's conclusion of 11 Memoranda of Understanding with 15 different CCP supervisors: *ESMA*, Annual Report on 2016, 2017, p. 61.

36 ESMA must recognise a third country CCP where it meets the four EMIR recognition conditions (a Commission equivalence decision is in place; the CCP is authorised and subject to effective third country supervision and enforcement; ESMA/third country supervisor cooperation arrangements are in place; and EMIR's requirements on compliance with anti-money-laundering and anti-terrorism financing standards are met), none of which require that the risk the CCP potentially poses to EU financial stability is assessed.

37 The Commission's US equivalence decision, e.g., requires that ESMA monitor US CCPs to ensure their internal systems support their compliance with identified EU rules: *ESMA*, Annual Report on 2016, 2017, p. 61.

38 *ESMA*, Annual Report on 2016, 2017, pp. 61–62.

39 E.g. *ESMA*, Response to the Public Consultation on the Operations of the European Supervisory Authorities, 2017, p. 3.

2.3 Effectiveness and Legitimacy as the Third Country Regime Comes under Pressure

The Commission regards the third country/equivalence regime as an EU-oriented process, primarily designed to safeguard the EU's financial stability and only secondarily concerned with market access. It also asserts, however, that the process is outcomes-based, concerned with results, and governed by proportionality and the need to achieve risk-based outcomes.[40] Despite this broadly accommodating external stance, the challenges raised by the third country/ equivalence regime have been extensively discussed since 2016 when it came under renewed scrutiny in the wake of the Brexit decision and the related reconsideration of CMU and the EU's position in the global capital market.

Multiple effectiveness challenges have been identified. These range from the silo-ed and partial nature of the regime which does not cover the full range of capital market activity; its procedural complexity; the slow pace of the equivalence process; the risks of the equivalence process becoming overly prescriptive;[41] the contingent nature of the Commission equivalence decision (which, as the Commission has repeatedly underlined, is unilateral and discretionary); the open-textured nature of the criteria that apply to equivalence; the risk of market disruption on a refusal or withdrawal of equivalence; and, more fundamentally, the risks the regime poses to the EU's competitiveness if access is deterred.[42] The challenges also include those related to the adequacy of legitimation and which flow from, for example, the opacity of the equivalence process; its limited justiciability;[43] and the extent of the Commission's control over what can be decisions of very high political salience to the EU. The specific challenges which will be faced by the UK as a major third country capital market have also been exhaustively examined.[44]

Less attention has been given to ESMA's increasing technocratic influence over the third country regime and to any related effectiveness and legitimacy risks. There is little evidence yet on how ESMA deploys its limited gatekeeping powers under the third country regime. The emerging evidence on CCP recognition certainly augurs well, suggesting an ESMA concern to ensure financial stability risks are monitored and managed. There is significantly more evidence on ESMA's role in the equivalence process. Here, the extent of ESMA's

40 Commission Equivalence Report 2017 (fn. 25).

41 In support of a flexible, outcomes-based approach to equivalence see *Jackson* (fn. 12).

42 For a specific example of stakeholder concern see, in the EMIR context, *Commission,* Impact Assessment for the 2017 EMIR Proposal (SWD(2017)246), p. 36.

43 See *Howell* (fn. 3).

44 For an industry perspective see *International Regulatory Strategy Group*, The EU's Third Country Regime and Alternatives to Passporting (2017).

influence – even allowing for the Commission's pre-eminence – places it close to politically sensitive market access determinations and so requires a focus on its effectiveness and legitimacy as a technocratic actor.

ESMA's effectiveness in this area can be related to its ability to provide the Commission with expertly-informed, practical assessments, which avoid prescription but are responsive to the different features of markets and financial governance internationally, and which rigorously deploy the conditions which the legislative process has applied to EU capital market access. In some respects, a timorous and accommodating approach to equivalence assessments might have been expected as ESMA, as a relatively new agency internationally, has strong incentives to build effective relationships with regulators internationally and not to antagonise major global market operators; in other respects, the political sensitivity of the equivalence process and the Commission's pre-eminence might have led ESMA to adopt a rigid, box-ticking approach. The evidence suggests, however, that ESMA has embraced its equivalence advice mandates with some confidence, generally deploying a technically expert, flexible and responsive, but also forensic, approach, which has provided the Commission with a secure evidence base on which to make equivalence decisions.

The first major test of ESMA's approach to equivalence came with the rating agency regime. Here ESMA adopted a pragmatic 'objective-based approach' under which the capabilities of the jurisdiction in question to meet the objectives of the EU's rating agency regime would be assessed from a holistic perspective.[45] ESMA's assessment of the equivalence of the US regime, for example, found that the few remaining uncertainties as regards equivalence were not capable of materially detracting from a positive equivalence finding; that ESMA had gained comfort from its discussions with the US regulator (the SEC); that the application in practice by firms of the US requirements would lead to equivalence; and that the equivalence review involved an assessment of the combined effect of the requirements reviewed and not only individual provisions. Similarly, while ESMA's 'second generation' 2017 equivalence advice on the rating agency regime was forensic and assertive (finding four of the nine jurisdictions reviewed were no longer equivalent), its approach overall was holistic and pragmatic. ESMA found, for example, that certain jurisdictions' regimes were equivalent to the EU rating agency regime even though these third country rules did not directly map on to the regime – the overall outcome achieved was sufficiently similar.[46] The other major body of evidence concerns

45 *ESMA*, Technical Advice on CRA Regulatory Equivalence – US, Canada and Australia (2012).

46 ESMA found e.g. that while the new EU rules on cross-ownership levels between rating agencies were not mapped in the US regime, the applicable US conflict of interest rules

ESMA's assessments of third country CCP regimes' equivalence. Here, in a politically complex context,[47] ESMA pursued a technically detailed but outcomes-based and pragmatic approach. From ESMA's initial Autumn 2013 series of equivalence assessments, the Australian CCP regime assessment[48] is indicative, being objectives-based; designed to assess, from a holistic perspective, the capability of the third country regime to meet the objectives of EMIR; and evidence-based, including on evidence derived from liaison with the relevant Australian authorities. ESMA also highlighted over this process its concern to consider the consequences for the EU regime were a regime to be found not to be equivalent and CCP access disrupted. ESMA further adopted a deft approach to navigating the international political sensitivities, deploying, as noted above, a 'conditional equivalence' model for those jurisdictions (the majority) for which it found that, while there were material divergences between the EU and the third country regimes, equivalence could be achieved by the CCP in question taking internal remedial action: ESMA Chair Maijoor highlighted that ESMA was concerned to avoid a 'zero sum' approach to equivalence.[49] Similarly, while ESMA was ultimately side-lined during the subsequent difficult EU/US negotiations on CCP equivalence, it was concerned to support a pragmatic solution and, following the final EU/US agreement, underlined that it "would do everything in its power" to shorten its review period for US CCP recognition in light of the time pressure which the lengthy equivalence negotiations had created.[50]

ESMA has also sought to mitigate the market uncertainties that equivalence decisions, or the absence thereof, can generate, including through its soft supervisory convergence tools. It has used its MiFID II/MiFIR Q&A, for example, to explain how the share trading obligation (which requires that certain shares must be traded on identified classes of trading venue in the EU or on equivalent third country trading venues) applies in relation to third country venues.[51] Overall, the evidence suggests that ESMA has been technically assured, outcomes-focused and pragmatic, but also forensic in assessing equivalence regimes and not afraid to find jurisdictions not equivalent. There are per-

achieved the same investor protection outcomes sought by the EU: ESMA CRA3 Update 2017 (fn. 19), pp. 79–87.

47 See *Peter Knaack*, "Innovation and Deadlock in Global Financial Governance: transatlantic coordination failure in OTC derivatives regulation", Review of International Political Economy 22 (2015), 1217.

48 ESMA/2013/1159.

49 Steven Maijoor, Speech on "International co-ordination of the regulation and supervision of OTC derivatives markets", 17th October 2013.

50 *ESMA*, ESMA Resumes US CCP Recognition Process Following EU-US Agreement, 10th February 2016.

51 *ESMA*, Press Release, 13th November 2017.

sistent and well-charted difficulties with the equivalence regime, but these tend to be associated with the Commission and not with ESMA.

ESMA's burgeoning influence, as an agency exercising delegated powers in an area of significant (and increasing) political sensitivity, raises nonetheless the prospect of legitimation risks, although there are mitigants. ESMA's supervisory/recognition/registration gatekeeping powers are limited, conferred in legislative measures, and subject to extensive proceduralisation in the relevant legislation[52] as well as to the constraints imposed by the EU Treaties, most notably the *Meroni* principle.[53] And as regards the equivalence process, the Commission remains the decision-maker and ESMA is formally an adviser only. Although the Commission usually follows ESMA's advice, it does not always and where equivalence becomes politically contested the Commission typically becomes the main EU actor, as has been the case with different EU/US negotiations. Legitimation concerns are not, however, absent and look set to increase given the recent adoption of a series of reforms strengthening ESMA's powers in 2019.

As the Brexit-era began to unfold from mid-2016 the challenges posed by the third country regime were, therefore, already clear. And while ESMA was emerging as an effective technocratic actor, nascent legitimacy strains could be identified. After the post-2016 outbreak of legislative reform – primarily associated with the CMU agenda and the 2017 European Supervisory Authority reform process, although very hard to disentangle from Brexit – all the current indications suggest there is political and institutional appetite for some reform, but for reform that retrenches the regime in an austere, stability-oriented, inward-facing, and increasingly centralised manner. At the same time, there is considerable appetite for empowering ESMA in this area. Whether or not the reforms will equip the EU optimally to navigate the post-Brexit environment is not clear.

3. *The Current Direction of Travel: An Austere Approach*

3.1 *Brexit as a Crucible for Change*

EU capital market regulation develops in fits and starts. While its evolution is typically incremental, shocks and crises reshuffle political and institutional interests, re-set priorities, and generate ingenious legal and political solutions to problems previously thought intractable or trivial. As has been exhaustively

52 MiFIR and EMIR set out in detail the scope and operation of ESMA's registration and recognition powers.

53 ECJ, 13th June 1958, *Meroni v High Authority*, Case 9-56, ECLI:EU:C:1958:7.

considered, the financial crisis provided the crucible within which the European System of Financial Supervision was forged, as well as Banking Union and the regulatory leviathan that is the single rulebook. Brexit might, accordingly, have been expected to shunt the third country regime at least a little from its current trajectory as interests and preferences were reset. That indeed seems to have happened, but not in a more liberal direction. While there are signs of the regime evolving, all the indications are of an increasingly austere approach. The changes are not, however, radical: the deference principle remains the basis of the third country regime.[54] Nonetheless, the evidence is pointing towards a more prescriptive, institutionalised, and 'on-shore' regime.

Prior to the Brexit decision and the emergence of the UK as a future off-shore, third country financial centre of systemic importance to the EU, the EU's third country regime for capital market access was a natural target for reform or at least for reconsideration. The EU capital market was recovering from the financial-crisis-era market and regulatory convulsions, and political and institutional space was opening up for reform. The CMU agenda, for example, launched in 2015, was bringing a sharper focus to bear on the third country regime and whether it supported the EU sufficiently in the global capital market.[55] Further, the EU was gaining experience with, and confidence in, ESMA as a technocratic vehicle for international financial regulatory policy; any reform of ESMA (finally launched in 2017[56]) might accordingly have been expected to engage with the third country regime.

Post-2016, Brexit might have been expected to generate additional reform impulses. On its withdrawal from the EU and after the transition period (expected to close at the end of December 2020), the UK will become a third country on which, at least based on current conditions, the EU will have a systemic dependence. Some 35% of the EU's capital market activity, and in particular much of its risk management capacity, is based in the UK. Early indications suggested that the UK was seeking a bespoke access arrangement for capital market services, based on the UK and EU recognising their respective regimes and on allowing regulatory divergence as long as high-level outcomes converged.[57] The

54 ESMA Chair Maijoor recently noted that "the underlying objective of an extensive use of deference by the EU has not a changed": Speech on "Building the EU Capital Markets Union while fostering Global Financial Markets", 10th October 2019.

55 *e.g.* ECOFIN Council Conclusions on the Commission Action Plan on Building a Capital Markets Union, 10th November 2015 (Council Document 13922/15), calling on the Commission to assess the impact of the different third-country regimes on European capital markets and on financial sector competitiveness.

56 COM(2017)536.

57 Prime Minister May's important Mansion House Speech (March 2018) called for an access arrangement based on a "collaborative, objective framework that is reciprocal, mu-

EU might similarly given the CMU agenda and the current identity between the EU and UK rulebooks, have been expected to consider some finessing of the third country/equivalence regime or some form of bespoke arrangement.[58]

All the current indications suggest, however, that neither the CMU agenda nor Brexit have driven a more liberal EU approach. The stability of the EU capital market, the autonomy of the single rulebook, and the enhancement of the EU's capacity to monitor third country actors, through ESMA, appear to be the driving concerns.

3.2 The Emerging Mosaic

With respect to UK market access specifically, all the indications are that the EU is unlikely to concede bespoke access arrangements. The March 2018 European Council Brexit negotiating guidelines do not expressly reference financial services/markets. They underline, however, that any future trade agreement in services must be consistent with the UK being a third country and operate on the basis of host state (EU) rules, and that any future framework must safeguard financial stability in the EU and respect its regulatory and supervisory arrangements.[59] The 2014-2019 European Parliament had expressly referenced the EU/UK financial services/markets relationship, but declared that the EU's third country regime must govern any UK access.[60] The October 2019 Revised Political Declaration on the framework for the future EU/UK relationship is similar in tone. It notes that the parties are committed to preserving financial stability, market integrity, and consumer/investor protection and fair competition, while respecting both parties' regulatory and decision-making autonomy and their ability to take equivalence decisions; it also

tually agreed, and permanent and therefore reliable for business"; and on the EU and UK maintaining the same "regulatory outcomes" over time: Speech on "Our future economic partnership with the European Union", 2nd March 2018. The UK industry had earlier pressed for such an approach (*e.g. UK Finance*, Supporting Europe's Economies and Citizens: A modern approach to financial services in an EU-UK Trade Agreement (2017)). A leading parliamentary report also called on the UK government to either secure substantial changes to the third country/equivalence regime or (the preferred option) ensure access through a bespoke free trade agreement incorporating mutual recognition mechanisms (*House of Lords, EU Committee*, 11th Report of Session 2017-2019, Brexit: the Future of Financial Regulation and Supervision (2018)).

58 As argued recently in: *Jonathan Faull/Simon Gleeson*, The Capital Markets Union: Should the EU shut out the City of London, Centre for European Reform, 2019.

59 European Council (Art. 50) Guidelines of 23th March 2018.

60 *European Parliament*, Resolution of 14th March 2018 on the Framework of the future EU-UK Relationship (P8_TA-PROV(2018)0069).

urges both Parties to start assessing equivalence under their respective frameworks as soon as possible.[61] There are no serious indicators, among the respectful aspirational statements in the Revised Declaration as to the importance of close regulatory and supervisory cooperation, of any EU appetite for a bespoke financial services/capital market access arrangement.[62] Most recently, the Commission's presentation to the Council on 10 January 2020 concerning the future relationship and cooperation and equivalence in financial services (available on the Commission's UKTF website) does not suggest any liberalisation of the EU's position, stresses that equivalence decisions are unilateral and discretionary, notes that the future relationship will not be "business as usual", and underlines that the EU will be led by its interests. Some indications of compromise could earlier be identified in the exceptional equivalence decisions taken by the Commission in April 2019 as regards the temporary equivalence/ ESMA-recognised status of three UK CCPs (and one UK CSD).[63] This was to ensure that, given the EMIR requirement that certain derivatives must be cleared on an EU CCP or equivalent third country CCP, the clearing of EU derivatives transactions could continue to take place in the UK (the major centre for the clearing of certain EU derivatives) on a 'no deal' exit; the financial stability risks to the EU if access to UK clearing services was abruptly ruptured drove this action. New Commission Vice-President Dombrovskis has also indicated that these decisions could be extended beyond their original March 2020 expiry date if it proves necessary in the future.[64] A different picture, however, emerges from the parallel MiFIR-related share trading obligation fracas. A no-deal UK withdrawal would also, given the scope of the MiFIR share trading obligation, have meant that certain EU shares could no longer be traded on leading London trading venues, in the absence of an exceptional equivalence decision by the Commission. Notwithstanding the significant liquidity and market disruption risks given the scale of EU share trading in London, the Commission did not take formal action, although ESMA sought to clarify the position to the extent it could within its mandate.[65] The market disruption risk was identified as significant, for the EU as well as the UK, and

61 Revised Text of the Political Declaration setting out the framework for the future relationship between the EU and the UK (TF50(2019) 65), 17th October 2019, para. 35.

62 The financial services section (paras. 35–37) is brief, short in detail, and long in worthy statements as to the need for cooperation.

63 Commission Implementing Decision (EU) 2019/544 [2019] OJ L95/9 and Commission Implementing Decision (EU) 2019/545 [2019] OJ L95/11.

64 *Commission Vice President Dombrovskis*, Speech on "Priorities of the new European Commission for Sustainability and Green Finance", 15 November 2019.

65 *ESMA*, Public Statement. Impact of Brexit on the Trading Obligation for Shares. 29 May 2019 (ESMA70-154-1204).

may arise again if the UK fails to agree an appropriate trade deal by the end of 2020.[66]

More generally, there are few signs that the emergence of the UK as a systemically-significant third country with an offshore capital market of acute importance to the EU is proving conducive to a rethinking of the third country regime's design. Early indications came in December 2017, when the Commission adopted a highly contested, restrictive, and time-limited (one-year) decision on the equivalence of Swiss trading venues for the purposes of the MiFIR share trading obligation. The positive equivalence decision, valid for one year only, made any further positive equivalence finding by the Commission contingent on resolution of a matter distinct from the EU capital market rulebook – the establishment of a new EU/Switzerland institutional framework for existing and future agreements relating to Switzerland's single market relationships.[67] Notwithstanding severe criticism from Switzerland and concern from the European Parliament,[68] the Swiss trading venue equivalence decision duly lapsed in summer 2019, with some initial disruption to market liquidity as trading migrated to alternative trading venues.[69] While specific to EU/Switzerland relations, it is not unreasonable to draw a lesson from the imbroglio as to the Commission's intention to signal its control over the equivalence process, and as to the unilateral and contingent nature of equivalence decisions.[70]

In a less febrile context, the Commission also recently carried out in its first-ever mass withdrawal of equivalence decisions. In summer 2019, a series of third countries lost their equivalence status as regards rating agency regulation following their failure to update their regimes in light of subsequent reforms to

66 The potential for market disruption from the related fragmentation of liquidity was raised by the Bank of England and the UK Financial Conduct Authority: *Bank of England*, Financial Stability Report (2019), p. 6 and *FCA Chief Executive Bailey*, Speech on "Preparing for Brexit in financial services: The state of play", 16 September 2019. The London Stock Exchange similarly warned of "many unintended consequences for the ability of market participants, in particular EU27 firms and their clients, to manage their portfolios and risk positions, and to achieve best execution": *London Stock Exchange*, Hard Brexit Impact Assessment, 5 September 2019, p. 3.

67 Commission Implementing Decision 2017/2441 [2017] OJ L344/52.

68 *European Parliament*, Resolution of 11 September 2019 on Relationships between the EU and Third Countries concerning Financial Services Regulation and Supervision (P8_TA(2018)0326), noting the "clear political dimension" of the Commission decision and calling for closer scrutiny by the Parliament.

69 ESMA reported in Autumn 2019 on the migration of trading from the EU back to Swiss trading venues: *ESMA*, Report on Trends, Risks and Vulnerabilities, No. 2 (2019), pp. 14–15.

70 See, e.g., *Dentons*, Stuck in Neutral: Switzerland's lost equivalence status, 7 August 2019.

the EU rating agency regime.[71] The context here is much less sensitive. There had been extensive discussions between the Commission and the relevant jurisdictions over time; ESMA had previously identified the difficulties; the states in question decided not to make the relevant reforms given the limited scale of the rating activity engaged; the Commission waited for six years before withdrawing equivalence; and the 'endorsement' regime, which runs alongside the rating agency equivalence/certification regime, provides a further access route.[72] Nonetheless, that the Commission is intent on a muscular, unilateral approach to equivalence, and on actively monitoring compliance with equivalence decisions, is clear. These withdrawals have also been interpreted as heightening UK fears regarding future market access.[73]

A similar signal was sent by the Commission in its July 2019 report on equivalence, the timing of which is unlikely to have been accidental.[74] As it did in its similarly-toned 2017 report,[75] the Commission underlined that equivalence was a tool for supporting financial stability and investor protection, as well as for facilitating an open and globally integrated EU capital market: it was "a flexible regulatory instrument capable of building bridges across jurisdictional fault-lines."[76] It warned, however, that while equivalence can increase market access opportunities, it was primarily a risk management tool. The tenor of the report was to emphasise the unilateral and discretionary nature of the equivalence tool, and that decisions can be suspended or withdrawn on the Commission's discretion, albeit that the Commission underlined the risk-based and proportionate nature of the assessment (although the Commission also emphasised that this meant that 'high impact' third countries could expect more stringent requirements). The Commission interpreted the recent package of legislative reforms to the equivalence system (noted ahead) as ensuring the system was more risk-based, better placed to take account of the impact of third country actors in the EU market, and had stronger capacity to monitor the status of regulatory and supervisory developments in third countries found to be equivalent. There is clearly little Commission appetite for any wholesale reform or liberalisation of equivalence (the Commission specifically rejected any

71 Five countries (Argentina, Australia, Brazil, Canada, and Singapore) lost their equivalence status. Four of these had earlier been identified by ESMA as no longer being equivalent, while as regard the fifth (Canada), its status had been identified by ESMA as being contingent on reforms (which did not follow).

72 See, e.g., *Commission*, Press Release on 'Financial Services: Commission sets out its equivalence policy with third countries', 29 July 2019.

73 *Jim Brunsden*, "EU Decision on Equivalence set to Heighten UK post-Brexit fear", Financial Times, 28 July 2019.

74 2019 Equivalence Report (fn. 10).

75 2017 Equivalence Report (fn. 25).

76 2019 Equivalence Report (fn. 10), p. 12.

move to a more standard, horizontal model) and much emphasis on better monitoring of equivalence decisions, stronger on-shore (ESMA-based) supervision of third country actors, and enhanced review of 'high impact' sectors or third countries.

The European Parliament has shown some interest in revising the equivalence regime, but it has adopted a cautious approach. Its recent September 2019 Resolution on third countries and financial services[77] did call for reforms, but these were largely procedural and institutional in orientation, particularly as regards the transparency of the regime, stronger European Supervisory Authority (ESA) powers to monitor and review equivalence decisions, and enhanced Parliament oversight in light of the "clear political dimension" of equivalence decisions (in a reference to the contested decision on Switzerland). The Resolution did not call for major substantive change. It also underlined that EU firms' passporting rights were of a different order to equivalence-related access rights, that no EU trade agreement had ever incorporated cross-border mutual access provisions on financial services, and emphasised the unilateral and contingent nature of equivalence decisions. By contrast, the earlier 2018 ECON Committee report on the Resolution was more ambitious, calling for the EU to give close consideration to the equivalence regimes between the EU and "high-impact third countries" in order to "develop stable and resilient regulatory relationships with those countries which have close financial links with the Union".[78]

3.3 Legislative Reforms

The direction of travel as regards legislative reform, and so as regards the Member States' preferences, is similar. The 2017 Securitisation Regulation, adopted in the immediate aftermath of the Brexit decision, failed to include a third country access regime, reflecting political tensions relating to the precedent it could potentially have established for post-Brexit UK access.[79] The 2017 Pro-

77 2019 European Parliament Third Countries and Financial Services Resolution (fn. 68).

78 *ECON Committee*, Draft Report on Relationships between the EU and Third Countries Concerning Financial Services Regulation and Supervision (2017/2253/NI), April 2018.

79 Regulation (EU) No 2017/2402 [2017] OJ L347/35. The new regime for 'simple, transparent, and standardised' (STS) securitisations does not include third country arrangements (although the Commission must by 2022 provide a report on whether to propose a third country regime), an unusual omission that has been related to uncertainty as to how to deal with the UK as a future major third country in this area (*Jim Brunsden*, "Plans to Boost Securitisation Market Stalls over Brexit", Financial Times, 6 February 2017).

spectus Regulation, a less contested measure, tightens the pre-existing market access system for prospectuses.[80] The previous 2003 Prospectus Directive permitted home supervisors (national competent authorities, NCAs) to approve a third country prospectus as long as it was drawn up in accordance with international standards and the third country rules were equivalent to those of the Directive: the regime was accordingly 'on-shored' in the EU in that third country prospectuses could not avoid the NCA approval process. The 2017 Regulation has added additional conditions to this regime and is more prescriptive as regards the home NCA approval.[81] The third country disclosure requirements must be equivalent to those of the Regulation; cooperation arrangements must in place between the home NCA and the relevant third country NCA, and these arrangements are subject to ESMA notification requirements and must comply with new administrative rules governing the minimum content of these arrangements (Article 30); and the now-standard requirements as regards the third country not being 'blacklisted' for its approach to anti-money laundering and counter-terrorism apply (Article 29). The Commission can establish general equivalence criteria in this area (but is not required to), and it may also adopt jurisdiction-level equivalence decisions, although it has yet to do either. The Regulation also provides for third country prospectuses to be drawn up in accordance with the Regulation and approved by the relevant home NCA (Article 28). Subsequently, the 2017 ESA reform package initially proposed that ESMA be conferred with approval and supervisory powers over third country prospectuses, in a material centralisation of the regime,[82] but this reform did not survive the negotiation process given significant Member State resistance. The most revealing evidence as to the direction of travel on third country access, however, comes from the package of measures adopted in the dying days of the 2014-2019 Commission and European Parliament terms.

The March 2019 agreement by the European Parliament and Council on a new Investment Firm Regulation, designed to enhance the prudential regulation of investment firms, contains a significantly more prescriptive and intrusive market access regime for third country investment firms than the current MiFIR regime.[83] The 2019 Regulation reforms the MiFIR regime by providing for more intensive assessment prior to the adoption of any equivalence decision; requiring enhanced assessment where third country firms have a systemic pre-

80 Regulation (EU) No 2017/1129 [2017] OJ L168/12.

81 The original Commission proposal was less restrictive.

82 COM(2017)536.

83 The proposals were reported as a significant toughening of the MiFIR equivalence regime: *Jim Brunsden*, "Brussels Signals Tough Stance on UK Bank Bonuses after Brexit", Financial Times, 19 December 2017.

sence in the EU; 'on-shoring' specific MiFID II/MiFIR requirements by making them directly applicable; conferring ESMA with additional supervisory powers; putting in place rigorous ex-post monitoring; and requiring enhanced and regular reporting to the Council and Parliament.[84] In particular, the equivalence assessment has become materially more risk-based. Where the scale and scope of the services provided by the relevant third country firm are likely to be of systemic importance, equivalence may only be granted after a "detailed and granular assessment" by the Commission of the prudential, organisational, and business conduct MiFID II/MiFIR rules that are subject to the assessment; and, in a significant operational intensification of the equivalence assessment, supervisory convergence between the EU and the third country is also to be assessed.[85] The Commission is further empowered to attach "specific operational conditions" to equivalence decisions to ensure that ESMA and NCAs have the necessary tools to prevent regulatory arbitrage and to monitor firms' activities in relation to equivalent third country rules relating to, specifically, the MiFID II/MiFIR share and derivatives trading obligations, post-trade transparency reporting, and transaction reporting. The threshold requirements as regards supervisory cooperation arrangements with third countries have also been enhanced. The requirement for information exchange procedures has been strengthened by new obligations for onward-sharing arrangements that allow ESMA to share third country information with NCAs, and also by new requirements for procedures to be adopted governing specific ESMA requests for information from third country firms. Further, the currently thin requirement for third countries to establish procedures for on-site supervision of firms in the EU has become a much more intrusive requirement for procedures governing coordination of investigations and on-site inspections by ESMA and NCAs. That the equivalence regime is contingent is made incontrovertible by the new requirement for ESMA to monitor regulatory and supervisory developments, enforcement practices, and relevant market developments in the third country in order to verify that the jurisdiction remains equivalent; and to monitor the systemic footprint of ESMA-registered third country firms. A related confidential report must be made to the Commission annually.[86] The signalling of intent is clear.

Once a third country investment firm is registered with ESMA, additional reporting requirements are imposed, many of which are directed to assessing the EU footprint of firms. Annual reports must be provided to ESMA on the scale and scope of firms' EU activities; firms' monthly minimum, average, and maximum exposure to EU counterparties; the total value of financial instruments

84 Regulation (EU) No 2019/2033 [2019] OJ L314/1. Revised Arts. 46, 47, and 49
85 Revised Art. 47.
86 Revised Art. 47.

(originating from EU counterparties) underwritten or placed in the previous year; the turnover and aggregated value of assets relating to EU activities; and, from a more regulatory perspective, investor protection, risk management and governance arrangements and any other information deemed necessary to enable ESMA and NCAs to carry out their tasks.[87] Firms must also retain at ESMA's disposal data relating to all orders and transactions in the EU for five years. ESMA's ongoing supervisory powers have also been enhanced, including by a new power for ESMA to request from third country firms any further information on their operations.[88] ESMA's disciplining powers have also been strengthened. In particular, ESMA's powers under MiFIR to withdraw a third country firm's registration have been strengthened by a new power to temporarily prohibit or restrict a firm from providing services where it does not comply with any exercise by ESMA or an NCA of MiFIR product intervention powers, or with an ESMA information request, or does not cooperate with an investigation or on-site inspection.[89] Overall, there is a strongly operational hue to the new regime, both as regards the initial equivalence assessment and in relation to ESMA's subsequent supervisory relationship with the third country firm. All in all, a materially more muscular and less deferential approach to third country access under MiFID II/MiFIR is signalled by the reforms.

The March 2019 agreement on reform of the ESAs similarly enhances the EU's monitoring powers over equivalence decisions.[90] ESMA is empowered to monitor developments in third countries found to be equivalent, particularly as regards financial stability, market integrity, investor protection, and single market functioning. It is also to verify ongoing compliance by third countries with equivalence decisions and to report confidentially to the Commission, Parliament, Council, and the other ESAs on its findings. If at any time ESMA identifies relevant developments that may impact on financial stability, market integrity, investor protection and single market functioning, it is to inform the institutions without delay. The procedural arrangements governing equivalence decisions are also strengthened in that any cooperation arrangements entered into with third country authorities are to allow information to be obtained by ESMA and to permit ESMA to follow up on equivalence decisions, including in relation to the operation of on-site inspections.[91] ESMA also acquires operational powers over third country benchmark administrators under these reforms, taking over the recognition process from NCAs in 2022.

87 Revised Art. 46.
88 Revised Art. 46.
89 Revised Art. 49.
90 Regulation (EU) No 2019/2175 [2019] OJ L334/1.
91 2019 ESA Reform Regulation, revised ESMA Regulation Art. 33.

Finally, the major and highly contested March 2019 'EMIR 2.2' reform is perhaps most revealing of the future direction of travel.[92] It puts in place a new regime for enhanced oversight of third country CCPs that are not systemically important ('Tier 1 CCPs'), including new information request and fining powers for ESMA; for the onshore supervision by ESMA of systemically significant, or likely to become systemically significant, third country CCPs ('Tier 2 CCPs'); and for the relocation to the EU of the most systemically significant CCPs – the critical assessment of systemic status is by ESMA.[93] These swingeing reforms reflect significant institutional (including from ESMA[94]) and political concern over the lack of EU oversight over third country CCPs,[95] but are hard to disentangle from Brexit-related interests in relocating clearing business from the UK. The relocation reform, in particular, has acute salience for the UK post-Brexit given its implications for the UK CCPs which dominate in euro-denominated clearing,[96] although its global implications for the clearing industry has led to a firestorm of criticism internationally.[97] While the co-legislators accepted the Commission's controversial 2017 proposal for an EU relocation mechanism, they also, however, accepted its less incendiary proposals for more intensive 'on-shore' ESMA supervision of Tier 2 CCPs. And it is these reforms which are the most revealing in terms of the thinking of the EU on third country access/equivalence; the relocation mechanism is of the most acute political salience, so is not an entirely reliable indicator of the direction of travel more generally. The new regime for Tier 2 CCPs certainly pre-

92 Regulation (EU) No 2019/2099 [2019] OJ L322/1.

93 ESMA has recently adopted its advice to the Commission on the Delegated Acts which will govern how the assessment is carried out: *ESMA*, Final Technical Advice on Criteria for Tiering under Article 25(2a) of EMIR 2.2 (2019).

94 ESMA Chair Maijoor repeatedly warned of the dangers of the EU's deference-based approach under EMIR to third country CCPs and of the related inability of the EMIR 'recognition' system to allow the EU to adequately address the stability risks posed by third country CCPs: "Keynote Speech", 23 January 2017.

95 The Commission warned of the risks to the EU from there being no direct involvement of EU supervisory bodies in the day-to-day supervision of third country CCPs, and of the imbalance between the EU's reliance on third country supervisors and third country regimes' insistence on direct oversight over third country (including EU) CCPs, particularly as the EU has the highest number of third country CCP access arrangements as compared to other jurisdictions internationally: *Commission*, Impact Assessment for the 2017 CCP/EMIR 2.2 Proposal (SWD(2017)148), pp. 42–43 and p. 45.

96 The relocation proposal received intensive attention in the UK (e.g. 2018 House of Lords Report (fn. 57), pp. 58–62 and pp. 91–92, acknowledging the EU's concerns regarding the UK 'off-shoring' of CCP business but concerned as to risks to the UK).

97 The relocation mechanism has generated significant concern, particularly from the US financial market. See, e.g., responses by the International Swaps and Dealers Association (US), ICI Global, and The Vanguard Group, https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-331/feedback_en?p_id=30988, 14 January 2020.

sages a more austere and less deferential approach, but there are also liberal elements.

Under EMIR 2.2, in order to be recognised, Tier 2 CCPs must comply directly with specific EMIR requirements, at the moment of recognition and on an on-going basis: the required third country equivalence determination on which CCP recognition depends does not accordingly suspend the application of a detailed swathe of EMIR requirements relating to capital, organisational, conduct of business, prudential, and interoperability requirements.[98] This represents a significant hardening of the EU's approach as it leads to the 'on-shoring' of Tier 2 CCP regulation and related supervision (by ESMA) alongside the equivalence determination, and so to a striking move away from the deference model. ESMA has been conferred with a related extensive, discrete set of direct supervisory powers over Tier 2 CCPs, including to make information requests, take investigatory actions, engage in on-site inspections, and take enforcement action (including the issuing of public notices, the imposition of injunctions and fines, and the withdrawal of recognition).[99] These operational supervisory reforms represent a major strengthening of ESMA's supervisory powers generally, in a sector of acute economic and political salience, and will require a very significant re-organisation of its governance arrangement to accommodate the complex decision-making procedures EMIR 2.2 imposes on ESMA as regards the supervision of Tier 2 CCPs.[100] The reforms also represent a striking extension of the EU's regulatory reach by applying a swathe of EMIR's rules directly. Accordingly, EMIR 2.2 shifts the CCP third country regime from being one based almost entirely on deference to home/third country supervision (once the equivalence decision is made and the CCP is 'recognised' by ESMA), to an 'on-shored' system based on the direct application of EMIR and much more intensive ESMA supervision and monitoring.

Significantly, however, the reforms accommodate some elements of deference, and it is in this regard that traces of a more liberal approach, and of a possible new direction for the future, can be identified. EMIR 2.2 provides that a Tier 2 CCP can be deemed to satisfy the directly applicable EMIR requirements by complying with the rules and regulations of its third country, as long as ESMA adopts a finding of "comparable compliance" as regards the relevant third country rules. A CCP can submit a reasoned request to ESMA asking that ESMA assess whether its compliance with identified third country rules is

98 EMIR 2.2, Revised EMIR Art. 25(2b)(a), subjecting Tier 2 CCPs to EMIR Art. 16, Title IV, and Title V.

99 Set out in detail in EMIR 2.2, revised EMIR Art. 25 and new Articles 25a–25q. ESMA's powers more-or-less follow the operational/procedural template that governs its direct supervisory powers over rating agencies (CCRAR) and trade repositories (EMIR).

100 See *ESMA*, 2020 Annual Work Programme (2019), pp. 13–14.

deemed to satisfy compliance with the directly applicable EMIR requirements[101]. ESMA's recently published advice to the Commission for the Delegated Acts to be adopted on the modalities governing comparable compliance[102] underlines both the rigour of this assessment – comparable compliance will not be easily achieved – but also the potential for deference. The comparable compliance assessment is clearly to be additional to and more intensive than the prerequisite jurisdiction-level equivalence assessment. ESMA has affirmed that the comparable compliance assessment is undertaken at CCP level, that it implies a detailed "requirement-by-requirement" analysis of the directly applicable EMIR rules against the relevant third country rules, that it should examine the "extent to which" a CCP's compliance with third country rules satisfies EMIR, and that any internal CCP rules and procedures that form an integral part of its legal and supervisory arrangements, being legally binding, are to be examined also.[103] ESMA has also firmly rebuffed the frequently-made argument from third country CCPs that the Commission's jurisdiction-level equivalence assessment suffices for the purposes of comparable compliance.[104] At the same time, there are indications of a more liberal approach. The EMIR 2.2 legislative scheme requires ESMA to adopt a proportionate approach, and ESMA has indicated that the assessment will be outcomes-based and be calibrated depending on the type of EMIR rules being assessed. In this regard, ESMA has proposed to the Commission that the directly applicable EMIR rules subject to the comparable compliance review be classified as "core" and "non-core".[105] As regards "core" requirements (ESMA has proposed a highly detailed and lengthy set of key EMIR rules as "core"), a finding of comparable compliance can follow, ESMA has proposed, where the third country rules, on an outcomes basis, are equal or at least as strict as (quantitative requirements) or conservative (qualitative requirements) as the EMIR rules: rules would therefore not need to be "literally identical".[106] And where the rules do not always meet this test, they could still be regarded as comparable where the CCP voluntarily adopted the relevant EMIR requirements. As regards "non-core" EMIR requirements, a finding of comparable compliance can follow where the third country rules can be regarded as a substitute for the EMIR

101 EMIR 2.2, revised EMIR Art 25a.

102 *ESMA*, Technical Advice on Comparable Compliance under article 25a of EMIR (ESA70-151-2649)(2019).

103 *Ibid,* pp.10-11.

104 Reaction from third country CCPs to ESMA's proposed approach was hostile, but primarily as regards the new legislative scheme moving away from 'full deference'. ESMA was assertive in noting that it had no jurisdiction to engage with comments calling for legislative revision of EMIR 2.2: *ibid*, 8.

105 *Ibid*, pp. 42–43 and pp. 44–46.

106 *Ibid*, p. 16.

requirements in that they achieve the same regulatory objectives, in accordance with ESMA guidance on how this test can be met. Further, where a finding of comparable compliance is made, ESMA has indicated that it will "normally rely" on the cooperation of the third country supervisory authority.[107] Finally, the "core" rules are designed to reflect the scope of the CPMI-IOSCO Principles for Financial Market Infrastructures, suggesting some ESMA sensitivity to international convergence in this area. Alongside these indications of an outcomes-based and proportionate approach, ESMA has also shown itself willing to address at least some third country CCP concerns, scaling back some of the provisions included in the "core" classification in response to feedback.[108] Much depends on how ESMA applies the new comparable compliance assessment, but it is not unreasonable to suggest that comparable compliance contains the seeds, at least, of a potential means for moderating and calibrating the 'on-shoring' of EU requirements being suggested by the current direction of travel.

3.4 The Political and Institutional Context

That the third country regime has not been radically recast (apart from as regards CCPs) is not a surprise, notwithstanding the Brexit shock. Political and institutional preferences as regards third country access have long been dynamic and divergent, and collective positions have not always been easy to establish.[109]

Overall, clashes tend to arise between those Member States open to liberalisation, and those concerned to limit market access, whether for competitive reasons or because of concerns relating to financial stability.[110] Brexit might, however, have been expected to generate some degree of collective Member State concern to signal open-ness and the attractiveness of the EU capital market, and thus some support for the regime to be liberalised. At the same time, there is much at stake for certain Member States from the reshuffling of UK-based business and from a more restrictive approach. The most radical reforms, the EMIR 2.2 reforms, can be associated with the significant and cohesive political

107 *Ibid*, p. 14.
108 *Ibid*, p. 18 and pp. 21–22.
109 See, e.g., *Quaglia* (fn. 5).
110 Different levels of national market exposure to international financial markets have been associated with e.g. different perspectives on financial stability: *Aneta Spendzharova*, "Banking Union under Construction: the impact of foreign ownership and domestic bank internationalization on EU Member States' regulatory preferences in banking supervision", Review of International Political Economy 21 (2014), 949.

interests in repatriating clearing activity from the UK to the EU and in building related national champions,[111] although even here there was division between the Member States.[112] Member States' preferences most usually vary by sector,[113] as is clear from the 2019 ESA Reform Regulation negotiations. For example, France's support over the Regulation negotiations for ESMA to be given more power to restrict NCAs from authorising the delegation of business to third counties was met by significant opposition from Member States who have a competitive advantage in such business (in particular Ireland and Luxembourg as regards the funds industry), and the delegation power was ultimately dropped. The proposed delegation reform was ultimately one of the most contested elements of the 2017 ESA Reform Proposal, generating concern that it prejudiced NCAs' autonomy in relation to the authorisation process, and so disturbed the pre-eminence of home NCAs as regards authorisation and in the granting of the single market passport under EU financial market legislation.[114] By contrast, ESMA's new equivalence monitoring and review powers under the 2019 ESA Reform Regulation are materially less salient for Member States than the proposed delegation reforms, and so it is not unexpected that the Commission's proposals here did not change very significantly over the negotiations. Nonetheless, the Member States' concern to protect their discretion as regards third country relations is clear from the Council's more light-touch approach to the administrative agreements to be adopted by Member States with third countries which ultimately prevailed over the Commission's earlier more prescriptive approach in the 2017 ESA Reform Propo-

111 France and Germany in particular have, since the Brexit decision, supported the repatriation of clearing in euro-denominated instruments to the EU. Shortly after the 2017 adoption by the Commission of its original EMIR 2.2 proposal, France and Germany called for an even tougher approach: *Reuters*, Market News, "France wants right to Veto Euro Clearing in the EU after Brexit – EU Sources", 6 September 2017. The major German CCP (Deutsche Börse's Eurex Clearing) is regarded as one of the potential beneficiaries of the new regime, although it has already taken pre-emptive action as regards clearing. In late 2017, e.g., it offered financial institutions a profit-based incentive to move clearing business to it: *Philip Stafford*, "Deutsche Börse makes ground in UK derivatives push", Financial Times, 5 February 2018.

112 A number of Member States, including Sweden, sought to lighten the relocation mechanism: *European Scrutiny Committee, House of Commons*, Report on EU Supervision of UK-based central counterparties after Brexit, 17 July 2019.

113 Member States' different competitive interests in attracting different aspects of relocated UK business became clear early on. Asset management business e.g., and France's related efforts to woo business, was an early flashpoint: *Owen Walker*, "Spooked Fund Managers look at Rivals to London", Financial Times, 17 February 2018.

114 Industry concern, particularly from the asset management sector which relies heavily on delegation arrangements, was acute (*Attracta Mooney/Jennifer Thompson*, "Europe's National Regulators Clash Over Delegation", Financial Times, 8 October 2017).

sal, which required Member States to notify ESMA in advance of any intention to conclude such an agreement with a third country and to provide it with drafts of any agreement. The 2019 Investment Firm Regulation's revision of the MiFIR third country regime for investment firms was also contested, reflecting the business interests at stake, with some Member States calling for a yet-more restrictive approach than that adopted.[115] Ultimately, much depends on Member States' respective competitive advantages in relation to UK-located and global business, and on whether these are or would be compromised by any change to the third country regime. It is not surprising therefore that major reform has been side-stepped.

Institutionally, the European Parliament has shown some interest in revising the third country/equivalence regime, but it is wary of the Commission's role in the equivalence process and in international financial governance,[116] and is likely to be suspicious of any reforms which include a strengthening of the Commission. The inter-institutional negotiations on the equivalence aspects of the 2019 ESA Reform Regulation, for example, saw the Parliament insert itself, alongside the Commission, as an institution to which ESMA was to report on its equivalence activities. The Commission can be expected to protect (and seek to strengthen) its institutional pre-eminence over the equivalence process and so to resist any efforts to lighten the equivalence process. While this is clear from its 2019 and 2017 Equivalence Reports, early 2017 also saw the Commission propose reforms to Comitology Regulation 182/2011 which governs equivalence decision-making[117] in order to reduce the number of abstentions on decisions and ensure the Commission receives stronger political guidance. This reform can be associated with a Commission concern to bolster itself against ex-post political risks when making equivalence decisions, as well as to signal its intention to remain pre-eminent as regards the procedural design of the process. The Commission can also be expected to protect the autonomy of the single rulebook and, accordingly, to resist any liberalisation of the current regime. But it might also be expected to see integration advantages in recalibrating the third country regime to support CMU and to buttress the single market against post-Brexit stability

115 France supported a significantly more restrictive approach than that adopted, based on requiring a branch or subsidiary: *Samuel Wilkes*, "French bombshell would gut MiFIR equivalence, say lawyers", Risk.net, 4 June 2018. The 'on-shoring' of certain MiFIR requirements (including the share and derivatives trading obligations), however, reflects France's interests: Speech by *AFM Chairman Ophèle*, "MiFID II's Practical Implementation 9 months on and post-Brexit Implications for our future Relationship with the UK", 1 October 2018.

116 *ECON Committee,* Report on the EU Role in the Framework of International Financial, Monetary and Regulatory Institutions and Bodies (A8-0027/2016), March 2016.

117 COM(2017)85.

risks: these interests might lead it to support some liberalisation of the regime. For the moment, however, autonomy and stability interests appear uppermost.

Finally, ESMA's expanding technocratic influence is relevant. Since the Brexit decision and over the ESA Review, ESMA has adopted an entrepreneurial posture, calling for a strengthening of its role,[118] and drawing on its experience with EMIR's third country CCP regime to argue that the lack of EU-level supervisory control over third country actors exposed the EU to risks. ESMA Chair Maijoor warned, for example, that the EU was an "island of equivalence" in a world which demanded supervisory oversight of third country actors.[119] ESMA advocacy aside, the institutional vehicle ESMA provides for reform, and the technical experience it has acquired in this area, can be associated with the recent operational/supervisory reforms. ESMA's operational capacity can also be expected to drive future centralisation of the regime. Overall, ESMA has emerged as the major institutional winner from the recent reforms to the third country regime. It has acquired significantly greater monitoring, supervisory, and enforcement powers, and so a firm foothold in what is likely to become an increasingly salient aspect of EU capital market law and policy.

4. A Modest Prescription: Watch, Reflect, and Strengthen Oversight

4.1 Risk Horizons and CMU

The recent reforms do not accordingly suggest a major re-set of the third country regime. The deference principle is broadly intact, and the EU remains concerned to be open to capital market business from outside the EU.[120] Nonetheless, that the regime is becoming more prescriptive and 'on-shored' seems clear. As to the implications, there are short-term and long-term horizons.

118 In its response to the Commission's 2017 ESA Review Consultation, ESMA called for enhanced supervisory powers and followed up with a call for direct supervisory powers over third country rating agencies, trade repositories, benchmarks, trading venues, and data services providers (*ESMA*, Letter to the Commission, 7 July 2017).

119 ESMA Chair Maijoor also queried in this intervention whether "sufficient assurance" was available that the risks of third country infrastructures in the EU were adequately assessed and addressed by the relevant third country regulator (fn. 94).

120 ESMA Chair Maijoor has recently noted that "a deep and vibrant financial market in Europe can only be built only with an active and direct participation of players from around the globe (fn. 54), while the Commission has linked enhancing the global attractiveness of the EU capital market to the success of the CMU project and underlined the importance of the equivalence regime in this regard: *Commission*, Capital Markets Union: progress on building a single market for capital for a strong Economic and Monetary Union (COM(2019)136).

In the short-term, the third country regime as currently configured and recently reformed may complicate, at least, UK access to the EU market. UK capital market actors can, of course, use different routes to the EU capital market which avoid the third country regime, whether by setting up subsidiaries; using subsidiaries but repatriating activities back to the UK;[121] or using other techniques such as 'reverse solicitation.'[122] The ECB appears sanguine as to the risks of an abrupt rupture from the UK capital market, and is primarily concerned with ensuring that the new pools of capital that may develop in the euro area are efficiently connected and with completion of the CMU agenda.[123] The Commission's main focus so far has been on securing financial stability, protecting the autonomy of the single rulebook and the integrity of the single market, ensuring sustainable liquidity, and avoiding any regional fragmentation where UK-based business disperses across the EU.[124] Nonetheless, there are material risks in the short-term to the EU from the abrupt excision of a significant aspect of its capital market into an off-shore jurisdiction.

In the long-term, it is unlikely that the EU will not benefit from a more liberal, or at least differentiated, approach to third country access to the EU capital market. The EU's longstanding concern to embed market finance more deeply in the bank-based EU financial system, currently being spearheaded by the CMU project, is a complex one given the structural features of the EU financial system.[125] Despite years of regulatory reform, which can be traced back to the 1999 Financial Service Action Plan, the EU financial system remains bank-based; further, capital markets in the EU are highly fragmented.[126] There is, as

121 ESMA made clear in a series of summer 2017 opinions, however, that NCAs are not to authorise subsidiaries where they are shell companies without an appropriate local risk management capacity. NCAs' approach to relocation-based authorisations is monitored through ESMA's Supervisory Convergence Network.

122 Under sectoral EU financial market legislation, services provided in response to a 'reverse solicitation' (e.g. when a client requests services from an investment firm) are not usually subject to EU law, although NCAs across the EU can take different approaches domestically to the extent to which they give local access to such business.

123 Speech by ECB Executive Board Member Couré on "European Capital Markets: priorities and challenges", 25 June 2019.

124 2019 Commission CMU Report (fn. 120).

125 See, e.g., *Manfred Kremer/Alexander Popov*, Special Feature A: Financial Development, Financial Structure and Growth: Evidence from Europe, in: ECB, Financial Integration in Europe (2018), p. 65 et seq. and *Iain Hardie/David Howarth* (eds.), Market-based Banking and the International Financial Crisis, 2013.

126 See recently *ECB*, Financial Integration in Europe (2018). Securitisation activity, venture capital funding, and private placements, e.g., are concentrated across different groups of Member States: *Commission*, Staff Working Document, Economic Analysis Accompanying the Commission Communication on the Mid-Term Review of the Capital Markets Union Action Plan (SWD(2017)224).

charted in the Commission's annual European Financial Stability and Integration Reports, compelling evidence that market finance has taken a stronger hold, particularly over the financial crisis period when bank lending was severely compromised. Bond issuances by non-financial corporates, for example, doubled over 2008-2014 and by 2016 the Commission was reporting that a transition to market-based funding was underway.[127] But this hold is not secure. The EU remains predominantly a bank-based system.[128] ESMA, for example, repeatedly reports on the long-term decline in prospectus authorisations, with 32.6% fewer prospectuses approved in 2018 as against 2007.[129] While this is only one indicator and there are many capital market substitutes to prospectus-based offerings of securities, the Commission's 2019 European Financial Stability and Integration Report[130] reported on a drop in market finance activity and also on a halt and some decline in integration levels, and ESMA has more generally reported on a persistent drop in levels of capital market funding since early 2015.[131]

This discussion is not concerned with the viability of, and the optimal elements of, any agenda to promote market-based funding in the EU; these are highly complex and contested questions. Neither are the implications of Brexit for market-based finance in the EU clear. But it can at least be suggested that the EU is not in a strong position to restrict access by the UK or by leading capital markets internationally, particularly as funding requirements become more complex and specialised, including as regards sustainable finance. The embedding of market finance in the EU is all the more a precarious project given some emerging evidence of Member States resisting the integration agenda. As noted above, the autonomy of the home NCA as regards authorisation of home capital market actors who can then passport across the EU was threatened by the Commission's 2017 proposed reforms to the ESMA Regulation as regards the authorisation process for actors planning to delegate their activities. While this reform was defeated during the negotiation process, it exposed support in some quarters for the passporting/integration model which underpins EU capital market regulation to be limited. In another straw in the wind, in summer 2019 the three ESAs issued a joint report on cross-border supervision of retail financial services which warned of a lack of clarity as to the respective roles of home and host NCAs, administrative weaknesses in the passporting system, and, more funda-

127 *Commission*, European Financial Stability and Integration Review 2016 (SWD(2016) 146).

128 *CEPS/EMCI*, Rebranding Capital Markets Union. A market finance action plan, 2019.

129 *ESMA*, EEA Prospectus Activity in 2018 (2019).

130 *Commission*, European Financial Stability and Integration Review 2019 (SWD(2019) 183).

131 *ESMA*, Report on Trends, Risks and Vulnerabilities, No. 2 (2019).

mentally, of the potentially limited incentives home supervisors had to supervise 'exported' firms and products.[132] Finally, while there are no serious indications that the UK will engage in anything like a 'race to the bottom' in financial regulation (the Bank of England, for example, has been clear as to the importance of strong prudential standards), there are some straws in the wind as to the potential for regulatory competition in some areas which could disrupt the EU market. The UK Financial Conduct Authority has recently indicated some appetite for re-visiting the UCITS fund rules, for example, and adopting a more principles-based model, a move which elicited a sharp response from ESMA Chair Maijoor as to the resilience and quality of the EU UCITS regime;[133] it also indicated support more generally for a "same outcome, lower burden" approach to any post-Brexit trade arrangement with the EU.[134] If the UK seeks to compete by reforming rules in certain sectors, while this is likely to make trade negotiations more difficult it also means that the EU capital market may struggle to attract and embed market-based funders such as investment funds.

4.2 A Modest Reform Prescription

Considerable uncertainty attends the third country regime. A swathe of important reforms has just been adopted and has yet to come into force. How ESMA will apply its new powers remains to be seen. The impact of Brexit on the EU capital market and on international capital flows into the EU is not yet clear. The UK's approach to future regulatory competition and/or cooperation with the EU is also not clear. Political and institutional interests are still in flux in the EU, particularly with a new Commission and European Parliament, and with Member States' interests still being reshuffled as the different implications of Brexit emerge. It will be some time before a clear picture of the third country context emerges. Accordingly, the time is not yet ripe for further reform. This is all the more the case as, if significant market dislocation hits the EU over the next few years as the UK disentangles itself from the EU, the Commission can always adopt equivalence/access decisions speedily and unilaterally. This is not to say, however, that the third country regime should be placed in cold storage awaiting developments. Two modest proposals are presented here.

132 *ESMA/EBA/EIOPA*, Joint Committee Report on Cross-border Supervision of Retail Financial Services (2019).

133 *Chris Flood*, "ESMA hits back at FCA's criticism of fund rules", Financial Times, 16 September 2019.

134 *Cat Rutter*, "FCA Chief eyes "lower burden" regulation after Brexit", Financial Times, 23 March 2019.

First, the seeds of a new and more finessed approach are in the current reforms. In particular, the tiering and comparable compliance approaches adopted in and trialled by EMIR 2.2 deserve greater examination. One approach to access/equivalence in the future could, for example, be the adoption of a tiered-system of jurisdictions internationally, with the level of equivalence/oversight required being calibrated according to the systemic importance of the jurisdiction, but as regards EU market efficiency and depth as well as regards financial stability. A series of concentric tiers could be established, with the lightest level of oversight applying to those systems with the closest regulatory and supervisory identity with the EU. Depending on the tiering (which could be assessed by ESMA and adopted by the Commission, overseen by the Parliament and Council, in the form of a Delegated Act, given the political interests at stake), different levels of equivalence assessment and related oversight could apply, ranging from comparable compliance through to direct 'on-shoring' of regulation and supervision. But before any such change is contemplated, experience with tiering and comparable compliance is required, and this will come with EMIR 2.2.

Second, policy attention could usefully focus on ESMA's oversight arrangements and whether they sufficiently secure appropriate legitimation for ESMA of its newly-enhanced powers.[135] From an effectiveness perspective, ESMA's strengthened powers are attractive, particularly as regards ESMA's enhanced oversight of third country actors in the EU market; ESMA has already shown itself to be an agile and purposeful supervisor.[136] But there are also legitimacy risks. Generally, while ESMA's exercise of its regulatory and direct supervision/supervisory convergence powers can be regarded as agile, data-informed and, overall, effective, ESMA's wide mandate and its purposeful application of its powers are bringing it closer to the contested grey zone between political/legislative and administrative action.[137] ESMA's new powers bring it even closer to this zone given the political salience of the third country regime. Certainly, the 2019 ESA Reform Regulation strengthens ESMA's foundational legitimation arrangements in some respects, including by specifying its mandate in greater detail, requiring additional reporting on and oversight of the extent

135 For a recent comparison of ESMA's legitimation arrangements against those of the Single Supervisory Mechanism, and calling for greater European Parliament oversight of ESMA, see *Elizabeth Howell*, "EU Agencification and the Rise of ESMA: Are its governance arrangements fit for purpose?", Cambridge Law Journal, 78 (2019), 324.

136 See further *Moloney* (fn. 8), ch. five and *Elizabeth Howell*, "The Evolution of ESMA and Direct Supervision: Are there implications for EU Supervisory Governance", Common Market Law Review 54 (2017), 1027.

137 See generally *Moloney* (fn. 8), examining ESMA's evolution since 2011 and considering is effectiveness and legitimacy.

to which ESMA acts proportionately, and imposing new institutional reporting obligations. But it does not disturb ESMA's core internal governance arrangements and in particular the pivotal role played by the decision-making Board of Supervisors, the voting members of which are exclusively NCAs, which also doubles as ESMA's internal accountability forum. This is in many respects welcome. The Commission's original 2017 ESA Reform Proposal provided for a new Executive Board, composed of appointed bureaucratic members (rather than representative NCAs), which would have been conferred with the supervisory powers and powers to take action against NCAs previously conferred on the Board of Supervisors, as well as new powers. This injection of bureaucracy, while designed to make it easier for ESMA to take decisions in the interests of the EU, particularly against NCAs, carried nonetheless the risk of deepening legitimation risks as it diluted the legitimation provided by the representative Board of Supervisors. But while the primacy of the Board was re-asserted over the negotiations, the opportunity was not taken to consider other internal governance remedies, such as the adoption of some form of 'oversight board', sitting above the Board of Supervisors and providing strategic advice and mandate challenge; the enhancement of the Board's oversight role, including by more intensive Board of Supervisors' consideration of ESMA decisions through new Board committees; the strengthening of European Parliament oversight through direct representation; or the dilution of the significant but opaque influence exercised by the Commission as a non-voting member of the Board of Supervisors.

ESMA's burgeoning influence, the conferral on it by the 2019 ESA Reform Regulation of additional powers (albeit of a more modest order than originally proposed by the Commission), and the only limited changes made to its governance arrangements would in any event have made careful review of ESMA's internal and external legitimating arrangements appropriate. But the need is particularly acute as regards ESMA's third country powers. ESMA's enhanced role in monitoring equivalence under the 2019 Investment Firm Regulation and the 2019 ESA Reform Regulation will draw it further into a process which can be expected to be more politically contested and to expose it to political risks. Legitimation risks also arise in relation to the threshold tiering determination by ESMA under EMIR 2.2 as to the systemic importance of a third country CCP, given the political and economic implications of any such decision. And while ESMA's new supervisory powers over third country investment firms (Investment Firm Regulation) and CCPs (EMIR 2.2) have a compelling logic as regards the need to protect EU financial stability, they also inject ESMA into direct supervisory relationships and so increase legitimation risks. This is not to say that ESMA's legitimation arrangements are not fit-for-purpose. A matrix of external institutional and judicial review procedures, accountability-related Commission, Council and Parliament reporting obligations, mandate constraints,

procedural dictates (including in administrative rules), budgetary review processes, internal structures (including the Board of Supervisors), and constitutional principles all serve to legitimate ESMA's actions. But the third country reforms represent a step-change in ESMA's powers and bring it closer to politically contested territory. Close attention will be needed to the resilience of its legitimation arrangements, whether by the European Parliament (perhaps in its regular Budget Discharge Resolutions) or by the Council, a body which has yet to assertively exercise its role as one of ESMA's accountability fora but which may come to do so given the increasing salience of the third country regime.

5. Conclusion

This article examines the EU's third country regime at a distinct inflection point in its development. An important series of legislative reforms, adopted in March 2019 as the 2014-2019 European Parliament/Commission term closed, provide a 'first look' at how institutional and political interests as regards third country access might be changing given Brexit and the related risk to the CMU agenda.

So far, it seems that the deference model which has long characterised the third country regime will remain in place, at least for the medium-term. It is, however, being diluted by means of more intensive monitoring of equivalence status and by the 'on-shoring' within the EU of third-country-actor supervision (through ESMA) and by the direct application of certain EU rules. It is also clear that there is limited political or institutional appetite for addressing the procedural and other weaknesses associated with the equivalence process. The most radical legislative reforms relate to third country CCP access under EMIR 2.2, where the EU has adopted a significantly more 'on-shored' approach, based on ESMA supervision, albeit that this incursion into the deference model is tempered by the new 'comparable compliance' tool. Overall, the third country regime is becoming more centralised, more 'on-shored' within the EU, and centralised, with ESMA the major institutional winner from the recent reforms. While any prediction in this area is fraught with difficulty, this development may pose risks to the CMU project as the EU capital market adjusts to the withdrawal of the UK.

The article also examines the second element shaping this inflection point in the development of the third country regime: the rise of ESMA. In recent years, ESMA has come to exert material but effective technocratic influence on the equivalence assessment process. It has also been conferred with a series of 'gateway' powers over third country actors; although there is only limited experience with these just yet, the CCP experience augurs well for the future. The material strengthening of ESMA's powers by the March 2019 reforms,

however, raises questions regarding the resilience of its legitimation arrangements. While a matrix of different legitimation mechanisms supports ESMA, these may come under increasing pressure as its influence over an increasingly highly-salient politically aspect of EU financial market policy deepens.

Mindful of the need to allow the current reforms to settle and be tested, a modest reform prescription, based on continued observation, the monitoring and potential expansion of the comparable compliance tool, and close attention to the resilience of ESMA's current legitimation arrangements is offered.