IRSG

INTERNATIONAL REGULATORY STRATEGY GROUP

Rt Hon Greg Clark MP
Financial Secretary
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

18 September 2013

Dear Greg,

I am writing to set out the views of the International Regulatory Strategy Group (IRSG), which I chair, on the third country provisions in the proposed revised Markets in Financial Instruments Directive and Regulation (MiFIDII/MiFIR). We have been liaising closely with your officials on this dossier.

The IRSG is a practitioner-led body comprising leading figures from the financial and professional services industry. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing industry views. It is an advisory body both to the City of London Corporation, and to TheCityUK.

As you know, the MiFIDII/MiFIR trilogues have now started and negotiations on third country issues are imminent. We believe that it is extremely important that effort is made at this time to seek an outcome that allows third country firms to continue to provide finance and investment opportunities to the real economy across Europe. The IRSG strongly supports the Council's position on this issue. However, we recognise that it is a compromise between Member States' positions and there is a risk it could unravel during the forthcoming trilogues.

Cross-border business - Equivalence and solicitation

We are concerned that the Commission's Proposal and the European Parliament's position on EU regulation on third country firms conducting cross-border business with EU counterparties would limit investment and funding opportunities by imposing barriers to third country firms providing valuable services to professional EU firms such as investment managers and corporates. We accept the need to protect retail investors. However, the Commission's Proposal would prohibit firms outside the EU from providing MiFID services and activities at all in the EU, even to banks, investment firms and other eligible counterparties or professional investors unless the relevant third country was judged by the Commission to have regulation with equivalent effect to MiFID and CAD requirements, and to provide reciprocal recognition of the EU prudential regulatory framework. The only exception proposed is where cross border services are provided at the initiative of the EU firm seeking investment services from the third country firm (the so-called 'solicitation test').

We are concerned that this proposal would in effect close the EU markets to investors and companies seeking finance from many third countries, especially emerging markets that may find it more difficult to obtain an assessment of 'equivalence' from the Commission. The UK's statutory exemptions such as the Overseas Person exemption work very well in practice and are widely used, and are vital to the UK's role as an international hub. For example, EU investment managers need to be able to invest freely in financial

instruments in all third country markets in order to deliver diversified long term value for EU investors. To be able to do this, they routinely use affiliates, custodians, brokers and asset managers in those third countries to provide them with required services ranging from advice, through execution, to safekeeping. Many of these services involve MiFID services. Similarly, EU brokers liaise routinely with local firms in third countries to help EU companies obtain finance from third country investors or to execute their clients' business in non-EU markets.

In order to provide their own services to EU and non-EU clients, EU firms need access to non-EU service providers. UK-based financial services firms and corporates deal with firms in dozens of countries around the world. It is unrealistic to expect that the European Commission would be able to carry out assessments on all these countries in any reasonable timeframe or that all or many of them would pass the proposed equivalence and reciprocity tests. However, closing off business between the EU and firms from those countries that are not assessed or do not pass the assessment would significantly restrict the ability of EU firms and corporates to access the services they need.

The proposed solicitation test is unlikely to help except perhaps in a few limited circumstances. Such a test cannot address the wide range of interactions and communications that are common in financial markets. For example, non-EU brokers for example will typically call existing and potential investment management clients with research ideas. A solicitation test could in fact prevent EU professional investors from getting the information and advice they need to make a sound investment decision. It is unrealistic to tell non-EU firms never to call or contact firms in the EU unless they are responding to a specific request.

Branches and subsidiarisation

We also have concerns with the Commission's Proposal and the European Parliament's position on EU branches of non-EU firms. Those proposals envisage that non-EU firms would only be able to conduct MiFID business through an EU branch if the firm's home country regime is assessed by the Commission as equivalent and as providing reciprocal recognition of the EU prudential regulatory framework.

The UK hosts branches of banks from more than 20 non-EU countries[1] and many of those banks conduct MiFID activities through those branches, engaging in business with clients and counterparties in the UK and outside the EU, as well engaging in business with clients and counterparties in other EU states where this is currently permitted. The UK regulators already assess the adequacy of the home state regime when authorising these branches and the UK financial centre and UK and EU markets derive significant benefits from these activities. There is a significant risk that the Commission would either not be able to assess these countries in a reasonable timeframe or, when it does so, would reach the conclusion that these countries fail one or more of these criteria. In particular, reciprocity is likely to be a significant issue in a number of countries, but closing our markets to banks from these countries would risk losing significant benefits for an

[1] Including Abu Dhabi, Australia, Bahrain, Brazil, Canada, India, Indonesia, Isle of Man, Israel, Hong Kong, Japan, Korea, Malaysia, Mexico, People's Republic of China, Qatar, Saudi Arabia, Singapore, South Africa, Switzerland, Taiwan, Thailand, Turkey, United Arab Emirates, USA (source PRA).

uncertain return and would create significant regulatory frictions for the UK, in particular with important new markets whose banks already operate here.

The IRSG has discussed with your officials the possibility that non-EU banks with UK branches might be able to respond to the closing of the UK market to their branches by transferring the activities currently conducted in those branches into UK subsidiaries. Such subsidiaries would need to be authorised in the UK, and so would not be third country firms. However, in many cases, moving MiFID regulated business into subsidiaries is likely to incur very high costs (both upfront and on an ongoing basis). A ban on a non-EU bank conducting MiFID regulated securities and derivatives business in its UK branch would also affect its ability to conduct other activities, such as custody business and transaction services business and related deposit taking activities in the branch, as these activities are often closely connected with and may not be readily separated from MiFID activities. It is unlikely to be practical to move all this business into a UK subsidiary. The fragmentation of the business into separate entities would significantly increase capital requirements and operational risks.

In addition, transacting business through a subsidiary in the EU would typically be contrary to the wishes of derivatives and other counterparties many of whom prefer to transact business with the principal foreign banking entity in the group because of its higher credit standing and the ability to achieve other benefits such as netting of positions held with different branches of the same legal entity.

In addition, we are also concerned that imposing reciprocity requirements on cross border business and branches contravenes the EU's commitments under GATS and risks legal challenge by other countries. Cutting off business between our markets and non-EU countries damages the UK and the EU. There are other ways of negotiating for improved access to non-EU markets and of encouraging moves to higher standards of regulation in those markets (e.g. through the G20 processes).

For the sake of the attractiveness of EU markets to third country investors and corporates seeking finance, and the EU's continued ability to offer a balanced environment for EU and non-EU financial services providers to carry on the full range of financial services business, the IRSG urges you to ensure that the outcome of the forthcoming trilogues takes these concerns into account, so that the final MiFIDII/MIFIR text continues to provide effectively for London's and the EU's central role in world finance.

Should you require any further information or clarification of the points raised in this letter, please contact me or Nick Collier (Global Head of Government Relations at Thomson Reuters) who chairs the IRSG MiFIDII/MiFIR workstream.

Rachel Lomax
Chair, IRSG Council