
Centre for International
Governance Innovation



British Institute of
International and
Comparative Law

Brexit: The International Legal Implications | Paper No. 14 – February 2018

How Does It Feel to Be a Third Country? The Consequences of Brexit for Financial Market Law

Matthias Lehmann and Dirk Zetsche



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Table of Contents

vi	About the Series
vi	About the Authors
vii	About the International Law Research Program
vii	Acronyms and Abbreviations
1	Executive Summary
1	Introduction
2	How European Financial Markets Law Operates
5	Third-country Access via the Principle of Equivalence
12	EU Subsidiary
14	Bilateral Market Access
15	Passive Use of the Freedom to Provide Services
16	Conclusion
18	About CIGI
18	À propos du CIGI
18	About BIICL

About the Series

Brexit: The International Legal Implications is a series examining the political, economic, social and legal storm that was unleashed by the United Kingdom's June 2016 referendum and the government's response to it. After decades of strengthening European integration and independence, the giving of notice under article 50 of the Treaty on European Union forces the UK government and the European Union to address the complex challenge of unravelling the many threads that bind them, and to chart a new course of separation and autonomy. A consequence of European integration is that aspects of UK foreign affairs have become largely the purview of Brussels, but Brexit necessitates a deep understanding of its international law implications on both sides of the English Channel, in order to chart the stormy seas of negotiating and advancing beyond separation. The paper series features international law practitioners and academics from the United Kingdom, Canada, the United States and Europe, explaining the challenges that need to be addressed in the diverse fields of trade, financial services, insolvency, intellectual property, environment and human rights.

The project leaders are Oonagh E. Fitzgerald, director of the International Law Research Program at the Centre for International Governance Innovation (CIGI); and Eva Lein, a professor at the University of Lausanne and senior research fellow at the British Institute of International and Comparative Law (BIICL). The series will be published as a book entitled *Complexity's Embrace: The International Law Implications of Brexit* in spring 2018.

About the Authors

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About the International Law Research Program

The International Law Research Program (ILRP) at CIGI is an integrated multidisciplinary research program that provides leading academics, government and private sector legal experts, as well as students from Canada and abroad, with the opportunity to contribute to advancements in international law.

The ILRP strives to be the world's leading international law research program, with recognized impact on how international law is brought to bear on significant global issues. The program's mission is to connect knowledge, policy and practice to build the international law framework — the globalized rule of law — to support international governance of the future. Its founding belief is that better international governance, including a strengthened international law framework, can improve the lives of people everywhere, increase prosperity, ensure global sustainability, address inequality, safeguard human rights and promote a more secure world.

The ILRP focuses on the areas of international law that are most important to global innovation, prosperity and sustainability: international economic law, international intellectual property law and international environmental law. In its research, the ILRP is attentive to the emerging interactions among international and transnational law, Indigenous law and constitutional law.

Acronyms and Abbreviations

AIFMs	alternative investment fund managers
AIFMD	Alternative Investment Fund Managers Directive
B2B	business-to-business
BaFin	German Financial Supervisory Authority
BGB	German civil code
CCPs	central counterparties
CFTC	Commodity Futures Trading Commission
CJEU	Court of Justice of the European Union
CSDs	central securities depositories
CSDR	Central Securities Depositories Regulation
ECB	European Central Bank
EEA	European Economic Area
EMIR	European Market Infrastructure Regulation
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
FATF	Financial Action Task Force
KWG	German Banking Act
MAR	Market Abuse Regulation
MiFID II	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
PRIIPS	Packaged Retail and Insurance-based Investment Products Regulation

Executive Summary

This paper analyzes options in financial market law available to British issuers, credit institutions, insurance companies, securities firms, and asset and fund managers in terms of Brexit, considering that the United Kingdom will become a third country from the perspective of the European Union. Whether London will continue to be the centre for European financial transactions will depend on its access to the Single Market. British companies will achieve market access via equivalence, by setting up a European subsidiary, through bilateral agreements and by passively using the fundamental freedom of services. The way to be taken will depend on the respective line of businesses and groups of customers. Nevertheless, even after Brexit, British companies will have to obey certain European laws if they want to maintain access to the Single Market. Moreover, future autonomous British law making will not be free from coordination with the Continent in order to ensure market access. Brexit will not impact all business models to the same extent; depending on the services offered, the clients served and the countries targeted, fundamental changes to the business model are to be expected (for example, a relocation of the European hub from London to the Continent, in particular in the banking and primary insurance markets), while, in other cases, the provision of services from London to the Continent may continue to function with few additional barriers, even in the status post-Brexit.

Introduction

At the current stage, nobody can predict either what the legal status of the United Kingdom will be after it has left the European Union,¹ or what the consequences of Brexit will be for the

European financial market.² Three basic scenarios can be envisaged: first, a close connection to the European Union, modelled on the European Economic Area (EEA), which would leave the United Kingdom with little autonomy and would ensure free movement of persons and services on an institutional level; second, a bilateral cooperation and partial Customs Union based on treaties, modelled on the relations of the European Union with Switzerland; and, finally, third-country status. None of these scenarios fulfills the promised triad created by Brexit promoters: greater legal autonomy, reduced immigration from Eastern Europe and continuous unlimited market access.³ The promises are legally incompatible⁴ and politically unrealistic,⁵ as the Union keeps emphasizing, given the European foreign trade and payments legislation.

This paper addresses the legal consequences of Brexit for the European financial markets law by focusing on regulatory issues,⁶ leaving aside the separate constitutional problems of EU treaties

1 See e.g. John Armour et al, "Brexit and Corporate Citizenship" (2017) 18:2 *Eur Bus Org Rev* 225; Catharine Barnard, "Law and Brexit" (2017) 33 *Oxford Rev Econ Pol'y* S4; Peter Böckli et al, "The Consequences of Brexit for Companies and Company Law" (2017) *Revue Trimestrielle de Droit Financier* 16; Paul P Craig, "Brexit: A Drama in Six Acts" (2016) *Eur L Rev* 447; Pavlos Eleftheriadis et al, "Legal Aspects of Withdrawal from the EU: A Briefing Note" (2016) *Oxford Legal Studies Research Paper No 47/2016*.

2 For a pessimistic view, see e.g. Dirk Schoenmaker, "The UK Financial Sector and EU Integration after Brexit: The Issue of Passporting" in Nauro F Campos & Fabrizio Coricelli, eds, *The Economics of the UK-EU Relationship: From the Treaty of Rome to the Brexit Vote* (London, UK: Palgrave Macmillan, 2017). A quite optimistic view is adopted by Wolf-Georg Ringe, "The Irrelevance of Brexit for the European Financial Market" (2017) *Oxford Legal Studies Research Paper No 10/2017*.

3 Jürgen Basedow, "Brexit und das Privat- und Wirtschaftsrecht" (2016) 24 *Zeitschrift für Europäisches Privatrecht* 567; Dörte Poelzig & Max Bärnreuther, "Die finanzmarktrechtlichen Konsequenzen des Brexit" in Malte Kramme, Christian Baldus & Martin Schmidt-Kessel, eds, *Brexit und die juristischen Folgen* (Baden-Baden, Germany: Nomos, 2016) at 154; Matthias Lehmann & Dirk Zetzsche, "Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK" (2016) 27 *Eur Bus LJ* 99 [Lehmann & Zetzsche, "Brexit and the Consequences"].

4 Cf Lehmann & Zetzsche, "Brexit and the Consequences", *supra* note 3; Poelzig & Bärnreuther, *supra* note 3 at 154 et seq.

5 Cf the Prime Minister of Luxembourg Xavier Bettel, quoted in Siobhan Fenton, "Brexit: UK warned 'it cannot have its cake and eat it' following 'secret memo' leak", *The Independent* (29 November 2016), online: <www.independent.co.uk/news/uk/politics/brexit-latest-secret-memo-leak-plans-cake-and-eat-it-a7445231.html>; German Chancellor Angela Merkel is quoted in Peter Taylor, "Angela Merkel: Theresa May cannot 'cherry pick' Brexit terms", *The Independent* (6 December 2016), online: <www.independent.co.uk/news/world/europe/brexit-angela-merkel-theresa-may-cannot-cherry-pick-terms-latest-eu-uk-a7458486.html>.

6 Cf Miguel Tell Cremades & Petr Novak, "Brexit and the European Union: General Institutional and Legal Considerations" (2017) *European Union Study for the AFCO Committee*; Menelaos Markakis, "Legal Issues Arising from the Brexit Referendum: A UK and EU Constitutional Analysis" (2017) 45 *Intl J Leg Info* 1; Ulrich G Schroeter & Heinrich Nemeček, "The (Uncertain) Impact of Brexit on the United Kingdom's Membership in the European Economic Area" (2016) 27:7 *Eur Bus L Rev* 921; Poelzig & Bärnreuther, *supra* note 3 at 156 et seq; Marc-Philippe Weller, Chris Thomale & Nina Benz, "Englische Gesellschaften und Unternehmensinsolvenzen in der Post-Brexit-EU" (2016) 69 *Neue Juristische Wochenschrift* 2378 at 2380.

law.⁷ It is based on the worst-case scenario that the United Kingdom and the European Union will fail to reach an agreement that deals with cross-border financial markets and services. This case is anything but unlikely, considering the short period of time for negotiations until March 29, 2019, and the complexity of financial markets law; in practical terms, it is also the only predictable case.

For the purposes of this paper, the term “capital markets law” is meant to refer to corporate law for companies seeking capital investment. The focus will be on market abuse and prospectus liability law, legal duties to periodical and ad hoc information (for example, in case of changes in major shareholdings in a company or inside information)⁸ and the law on takeovers. In terms of financial services covered, the paper will focus on European regulation of markets for individual and collective investments and on the regulation of banks and insurances, including

the role of counterparties.⁹ Further, the paper will consider financial regulation relating to the infrastructure of financial markets, such as central counterparties (CCPs) and central securities depositories (CSDs), as well as transaction registers or trade repositories.

Connecting factors and the consequences of European financial markets law will be elaborated, followed by the analysis of the four recognized ways of market access (equivalence, EU subsidiary, bilateral agreement and the use of passive fundamental freedom of services), against the assumption that the United Kingdom will become a third country.

How European Financial Markets Law Operates

Connecting Factors

The applicability of European financial markets law can arise from one of three connections: the location where an event takes place (the territoriality doctrine), the location where a transaction takes place (the market doctrine)

7 Cf EC, Directorate-General for Internal Policies of the Union, “Implications of Brexit on EU Financial Services: Study for the ECON Committee” (June 2017); John Armour, “Brexit and Financial Services” (2017) 33:1 *Oxf Rev Econ Pol’y* 54; Elis Ferran, “The UK as a Third Country Actor in EU Financial Services Regulation” (2017) 3:1 *J Fin Reg* 40; Poelzig & Bärnreuther, *supra* note 3 at 153 et seq; Schoenmaker, *supra* note 2.

8 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, [2014] OJ, L 173/1 [Market Abuse Regulation]; Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, [2003] OJ, L 345/64, art 4(1)(3) [Prospectus Directive]; Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, [2017] OJ, L 168/12 [Prospectus Regulation]; Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, [2004] OJ, L 390/38 [Transparency Directive]; Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, [2004] OJ, L 142/12 [Takeover Directive]; Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, [2017] OJ, L 132/1 [Shareholder Rights Directive]. Additionally, Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, [2012] OJ, L 86/1 [Short-selling Regulation] and Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014, [2016] OJ, L 171/1 [Benchmark Regulation].

9 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, [2013] OJ, L 176/338 and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, [2013] OJ, L 176/1 [CRR]; Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, [2014] OJ, L 173/349 [MiFID II] and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, [2014] OJ, L 173/84 [MiFIR]; Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, [2012] OJ, L 201/1 [EMIR]; Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, [2011] OJ, L 174/1 [AIFMD]; Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), [2009] OJ, L 302/32 [UCITS Directive]; Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, [2013] OJ, L 176/338 [CRD IV].

or the location where a particular behaviour, relevant in terms of financial markets law, has consequences (the effects doctrine).¹⁰

The territoriality doctrine means that the authority at the seat or headquarters of the company¹¹ is competent for licensing and supervision.¹² It applies for the licensing of credit institutions, insurance companies, securities firms and funds. The market doctrine is followed with regard to market regulation,¹³ including market integrity,¹⁴ the distribution of financial products under the prospectus liability and investment law,¹⁵ and takeover bids.¹⁶

The effects doctrine applies wherever events in third countries can have a negative impact on

investor protection or the integrity and stability of financial markets, for instance, with regard to access to EU trade centres, central clearing systems and CCPs,¹⁷ trade repositories, credit rating systems,¹⁸ insider trading, short sales and shareholder transparency.¹⁹ The connection to effects can be found, for instance, in the Market Abuse Regulation (MAR), the Short-selling Regulation and the Transparency Directive.²⁰ These acts apply to persons acting or located in a third country when they conclude a contract or transaction with EU parties, or when their activities generally interfere with the European market. Therefore, it is insignificant whether or not insider trading, short selling or the acquisition of controlling interests takes place in the European Union or the United Kingdom; EU law will have to be obeyed in Britain before and after Brexit.

Efficiency Benefits from EU Membership

Within the EU/EEA Single Market, the territoriality doctrine is overcome by European passports. In principle, an issuer or intermediary that is admitted in its state is required to hold a permit for distribution of its financial instruments or products abroad. Requiring these permits to be acquired for distribution in each and every foreign state would result in excessive costs. Therefore, under the so-called country of origin principle of EU law, admittance in the state of origin suffices for distribution throughout the European Union and the EEA. The admitting authority of the state of origin must merely notify the other member state before the financial firms can start activities in the latter.²¹ Consequently,

- 10 Dirk Zetzsche, "Drittstaaten im Bank- und Finanzmarktrecht" in Gregor Bachmann & Burkhard Breig, *Finanzmarktregulierung zwischen Innovation und Kontinuität in Deutschland, Europa und Russland* (Tübingen, Germany: Mohr, 2014) at 92 et seq [Zetzsche, "Drittstaaten"]; Matthias Lehmann, *Münchener Kommentar zum BGB, IntFinMarkR*, 7th ed (Munich, Germany: CH Beck, 2017) at para 112 [Lehmann, *Münchener Kommentar*]; Poelzig & Bärnreuther, *supra* note 3 at 161 et seq.
- 11 See European Parliament and Council Directive 95/26/EC of 29 June 1995 amending Directives 77/780/EEC and 89/646/EEC in the field of credit institutions, Directives 73/239/EEC and 92/49/EEC in the field of non-life insurance, Directives 79/267/EEC and 92/96/EEC in the field of life assurance, Directive 93/22/EEC in the field of investment firms and Directive 85/611/EEC in the field of undertakings for collective investment in transferable securities (UCITS), with a view to reinforcing prudential supervision, [1995] OJ, L 168/7, art 3.
- 12 Cf CRD IV, *supra* note 9, art 3(1)(39); CRR, *supra* note 9, art 4(1); MiFID II, *supra* note 9, arts 4(1)(55), 5(1), 67; Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, [2014] OJ, L 257/1, arts 2(1)(23), 10 [CSDR]; AIFMD, *supra* note 9, arts 4(1)(q), 6(1) (generally, statutory seat; in certain cases, state of reference).
- 13 Cf CRD IV, *supra* note 9, art 44 et seq; MiFID II, *supra* note 9, art 3 et seq; MiFIR, *supra* note 9. Cf Dirk Zetzsche & David Eckner, *Europäisches Kapitalmarktrecht: Grundlagen* in Martin Gebauer & Christoph Teichmann, *Enzyklopädie Europarecht*, vol 6 (Baden-Baden, Germany: Nomos, 2016), § 7A at para 155 et seq; Dirk Zetzsche & Christina Preiner, "Europäisches Kapitalmarktrecht: Intermediärsrecht" in Gebauer & Teichmann, *ibid*, § 7B at para 178 et seq.
- 14 Dirk Zetzsche, "Europäisches Kapitalmarktrecht: Marktintegrität/ Marktmissbrauchsrecht" in Gebauer & Teichmann, *supra* note 13, § 7C at para 43 et seq [Zetzsche, "Marktintegrität/Marktmissbrauchsrecht"]; Dirk Zetzsche & Wilhelm Wachter, "Europäisches Kapitalmarktrecht: Unternehmenskapitalmarktrecht" in Gebauer & Teichmann, *supra* note 13, § 7D at para 102 et seq.
- 15 Cf Prospectus Regulation, *supra* note 8, art 29; AIFMD, *supra* note 9, art 31 et seq; MiFID II, *supra* note 9, recitals 39, 54, 71, arts 16(3), 24 et seq.
- 16 Cf Takeover Directive, *supra* note 8, art 4(2). The market doctrine applies because, in cases of a divergence between the statutory seat and the place of trading, the place of trading prevails; see Ulrich Noack & Timo Holzborn in Eberhard Schwark & Daniel Zimmer, eds, *Kapitalmarktrechts-Kommentar*, 4th ed (Munich, Germany: CH Beck, 2010), § 2 WpÜG at para 3.

17 MiFIR, *supra* note 9, arts 28(4), 38(1).

18 Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies, [2013] OJ, L 146/1, art 4 [Credit Rating Agency Regulation]; CSDR, *supra* note 12, art 19(6); EMIR, *supra* note 9, arts 25, 75 et seq.

19 Cf Short-selling Regulation, *supra* note 8, art 1(1)(a); Transparency Directive, *supra* note 8, art 9(3)(2), as well as Market Abuse Regulation, *supra* note 8, arts 2(3), 2(4); Zetzsche, "Marktintegrität/ Marktmissbrauchsrecht", *supra* note 14, § 7C at paras 5, 43 et seq.

20 Cf Market Abuse Regulation, *supra* note 8, art 2(4) ("The prohibitions and requirements in this Regulation shall apply to actions and omissions, in the Union and in a third country, concerning the instruments referred to in paragraphs 1 and 2"); Transparency Directive, *supra* note 8, art 9(2), on the acquisition or change of major holdings ("Where the issuer is incorporated in a third country, the notification be made for equivalent events").

21 Cf MiFID II, *supra* note 9, arts 34(2), 34(3); Zetzsche & Preiner, *supra* note 13, § 7B at para 99 et seq; Lehmann, *Münchener Kommentar*, *supra* note 10 at para 124; Poelzig & Bärnreuther, *supra* note 3 at 164 et seq.

specialized financial services can be concentrated at the most suitable location. This has allowed the accumulation of banking in London (so far), Frankfurt and Paris, of funds management in Dublin and Luxembourg, of insurances in the United Kingdom, France, Germany, Italy and the Netherlands, and of stock market liquidity in Amsterdam, Milan and elsewhere. Issuers and intermediaries from third countries, in principle, do not enjoy these benefits as a consequence of the fact that their home countries are not members of the Single Market. These operators must apply for admission in each and every member state, which also results in the doubling up of supervisory law, save for a few exceptions, which will be addressed below.

Opportunities through Third-country Status

Being part of the EU financial market is not only a blessing; it also comes with obligations. In some areas, the opportunity for autonomous law making could be an advantage.

Financial Markets Law

In the area of financial markets law, three examples can be given in which EU law is particularly onerous. First, banks have to comply with complex regulation that covers the constitution, organization, day-to-day work and remuneration of boards of directors.²² The impact of EU remuneration policy, especially the cap for variable parts, in other words, *boni*, to the equivalent of an annual fixed salary, reduces the attractiveness of the European Union as a financial market. Second, European fund managers have to comply with transparency requirements and the prohibition against asset stripping when acquiring companies not listed on a stock exchange.²³ The result is higher costs

and complexity of private equity transactions. Third, the Shareholder Rights Directive²⁴ stipulates cost-intensive rules for portfolio managers, shareholder services and issuers. These onerous requirements apply to entities governed by EU law under the territoriality doctrine, for instance, where the adviser has his or her residence or branch in the European Union, or where a listed company has its seat in the European Union and its shares are traded there.²⁵ The Shareholder Rights Directive, as amended, does not provide for a combination with the effects doctrine that is well-known in financial markets law. A firm can easily free itself from these and other duties connected to the company seat by maintaining or transferring its seat to the United Kingdom. This is an invitation to regulatory arbitrage.

Consequences for Investors

While a third-country investor usually becomes a shareholder or, in the case of trust, a beneficiary, it is also possible that the investor merely holds a contractual right called “securities entitlement.” The difference between the two models matters, as shareholders are protected differently from co-contractors, who merely benefit from information duties (prospectus liability and incorrect advice) and not from genuine shareholder rights. In the future, this difference will become even more important because it is to be expected that the European Union and the United Kingdom will position themselves on the opposite sides of investor/shareholder protection. It cannot be excluded, however, that EU company law and trust law will take customers’ interests into account by tightening the regulation.²⁶

22 Cf CRD IV, *supra* note 9, art 91 et seq; Luca Enriques & Dirk Zetzsche, “Quack Corporate Governance, Round III? – Bank Board Regulation Under the New European Capital Requirement Directive” (2015) 16:1 *Theor Inq L* 211; Guido Ferrarini, “Regulating Bankers’ Pay in Europe: The Case for Flexibility and Proportionality” in Helmut Siekmann, ed, *Festschrift für Theodor Baums* (Tübingen, Germany: Mohr Siebeck, 2017) 401; Peter O Mühlbert, “Corporate Governance von Banken: Ein europäisches Konzept?” (2014) 113 *Zeitschrift für Vergleichende Rechtswissenschaft* 520.

23 Cf AIFMD, *supra* note 9, art 25 et seq; Dirk Zetzsche, “Anteils- und Kontrollwerb an Zielgesellschaften durch Verwalter alternativer Investmentfonds” (2012) 15 *Neue Zeitschrift für Gesellschaftsrecht* 1164; Clerc in Dirk Zetzsche, *The Alternative Investment Fund Managers Directive*, 2nd ed (Alphen aan Rijn, Netherlands: Wolters Kluwer, 2015) 649 [Zetzsche, AIFMD].

24 *Shareholder Rights Directive*, *supra* note 8.

25 Cf in particular Directive 2017/828 (*Shareholder Rights Directive II*). Dirk Zetzsche, “Langfristigkeit im Aktienrecht? Der Vorschlag der Europäischen Kommission zur Reform der Aktionärsrechterichtlinie” (2014) *Neue Zeitschrift für Gesellschaftsrecht* 1121.

26 On the United Kingdom’s options under the equivalence regime, see Ferran, *supra* note 7. For the possibility of lowering investor protection, see Poelzig & Bärnreuther, *supra* note 3 at 160 et seq.

Third-country Access via the Principle of Equivalence

Some European legal instruments allow third-country companies to access the Single Market without the need for EU authorization, provided their home country subjects them to equivalent regulation and supervision. This equivalence mechanism²⁷ also exists — though in a very limited way — in US law, where it is known as substituted compliance.²⁸ Its function is to exempt cross-border trading companies from double regulation and supervision. At the same

time, this mechanism grants domestic investors free access to third-country services providers, so that the investors can select their providers based solely on performance, rather than location. This fosters product innovation and competition. The requirement of EU equivalent regulation and supervision maintains a level playing field. It also reflects the intimate connection that exists between mutual recognition and minimum harmonization, which has long been known from the intra-EU context: states will open their markets to foreign firms only under the condition that the foreign firms' countries of origin submit them to a minimum of regulatory standards and supervision. In the international context, the degree of harmonization is less stringent. One could therefore speak of "regulatory alignment," rather than "regulatory harmonization." Nevertheless, this alignment is the *quid pro quo* of market access.

27 Cf EC, Directorate-General for Internal Policies of the Union, *supra* note 7 at 23 et seq; Ferran, *supra* note 7; Matthias Lehmann, "Legal Fragmentation, Extraterritoriality and Uncertainty in Global Financial Regulation" (2017) 37:2 *Oxford J Leg Stud* 406 at 430 et seq; Niamh Moloney, "Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market" (2017) London School of Economics Legal Studies Working Paper No 5/2017 [Moloney, "Brexit, the EU and its Investment Banker"]; Niamh Moloney, "Brexit: An Uncertain Future for the City?" (2016) 17 *German LJ* 75; Lucia Quaglia, "The Politics of 'Third Country Equivalence' in Post-Crisis Financial Services Regulation in the European Union" (2015) 38 *Western Eur Pol* 167; Rolf Sethe, "Das Drittstaatenregime von MiFIR und MiFID II" (2014) 86 *Schweizer Zeitschrift für Wirtschaftsrecht* 621 [Sethe, "Drittstaatenregime"]; Rolf Sethe & Rolf Weber, "Äquivalenz als Regelungskriterium im Finanzmarktrecht" (2014) 110 *Schweizer Juristen-Zeitung* 569; Eddy Wymmersch, "Brexit and the Equivalence of Regulation and Supervision" (2017) *European Banking Institute Working Paper Series 2017 No 15*, online: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3072187>; Zetzsche, "Drittstaaten", *supra* note 10 at 60; Dirk Zetzsche, "Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements" in Ross P Buckley, Emiliós Avgouleas & Douglas W Arner, eds, *Reconceptualising Global Finance and its Regulation* (Cambridge, UK: Cambridge University Press, 2016) 391 [Zetzsche, "Competitiveness"].

28 On the determination of substituted compliance for certain swap regulations by the Commodity Futures Trading Commission (CFTC) under Title VII of the Dodd-Frank Act and CFTC regulations, see CFTC, "Cross-Border Application of Swaps Provisions", online: <www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/Cross-BorderApplicationofSwapsProvisions/index.htm>. Howell E Jackson, "Substituted Compliance: The Emergence, Challenges, and Evolution of a New Regulatory Paradigm" (2015) 1:2 *J Fin Reg* 169; Sean J Griffith, "Substituted Compliance and Systemic Risk: How to Make a Global Market in Derivatives Regulation" (2014) 98 *U Minn L Rev* 1291 at 1293–94 ("Regulatory uniformity, in general, is a highly suspect means of addressing systemic risk" and "a better approach to derivatives regulation would be to adopt a more supple regulatory superstructure that encourages a diversity of approaches to achieve the objective of minimizing systemic risk"); North, Bar & Plotnick, "The Regulation of OTC Derivatives in the United States of America" in Rüdiger Wilhelmi et al, eds, *Handbuch EMIR* (Berlin, Germany: Erich Schmidt Verlag, 2015) 618 [Wilhelmi, *EMIR*]. On the potential application to foreign broker dealers and exchanges, see Steven Davidoff Solomon, "Rhetoric and Reality: A Historical Perspective on the Regulation of Foreign Private Issuers" (2010) 79 *U Cinn L Rev* 619 at 633.

Scope

The equivalence mechanism has a long tradition in prospectus law with regard to transparency duties,²⁹ especially of foreign accounting standards and of respective auditing.³⁰ Beyond this area, equivalence has been promoted by the Financial Stability Board with regard to derivatives regulation,³¹ where national fragmentation leads not only to additional costs and deficits of supervision, but also to risks for the stability of the financial system.³²

29 Cf *Prospectus Regulation*, *supra* note 8, art 29. On the previous law, see Pierre Schammo, *EU Prospectus Law* (Cambridge, UK: Cambridge University Press, 2011) at 142–92.

30 Cf *Commission Regulation (EC) No. 1569/2007 of 21 December 2007 establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament and of the Council*, [2007] OJ, L 340/66; *Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC*, [2013] OJ, L182/19, art 47 [*Financial Statements Directive*].

31 Cf Zetzsche, "Competitiveness", *supra* note 27 at 399 et seq. Transposed in the European Union in *EMIR*, *supra* note 9, art 25(6), 75.

32 Cf Rüdiger Wilhelmi & Benjamin Bluhm, "EMIR als Regulierung systemischer Risiken" in Wilhelmi, *EMIR*, *supra* note 28 at 21; Rüdiger Wilhelmi, "Grenzüberschreitende Derivate, zentrale Gegenparteien und EMIR" in Dirk Zetzsche & Matthias Lehmann, *Grenzüberschreitende Finanzdienstleistungen* (Tübingen, Germany: Mohr, 2018), § 10 at 315 [Zetzsche & Lehmann, *Finanzdienstleistungen*].

Recently, the principle has become more widespread throughout EU financial markets law. It has been embraced, in particular, by the Alternative Investment Fund Managers Directive (AIFMD)³³ and the Markets in Financial Instruments Directive (MiFID II),³⁴ allowing equivalently regulated and supervised intermediaries from third countries to offer securities and fund services for professional EU customers and investors. Another area in which the principle has been adopted is financial market infrastructure, especially in the European Market Infrastructure Regulation (EMIR), which grants third-country access to EU CCPs and trade repositories and allows EU parties the clearing through third-party CCPs,³⁵ the Credit Rating Agency Regulation, permitting the use of the rating by equivalently regulated rating agencies for regulatory purposes in the European Union,³⁶ and the Central Securities Depositories Regulation (CSDR), which allows CSDs from third countries to establish branches in the European Union and to form transnational holding chains with EU CSDs. The aim of opening up the Single Market for financial services toward third-country providers is twofold: first, to extend the range of offers, thereby to enhance competition,³⁷ and, second, to achieve greater resilience against smaller crises by establishing a global infrastructure system. The same motivation underlies the introduction of equivalence in the reinsurance market,³⁸ which is of particular relevance for the stability of the financial system as it allows for spreading major national risks globally.

By contrast, banks and primary insurers from third countries do not enjoy EU market access via equivalence. Instead, they need to set up a self-functioning EU/European Economic Community subsidiary, in terms of organization and capital, if they want to serve clients on the European continent. The only simplification is granted

to cross-border groups by the consolidated supervision of the EU subsidiary and its third-country parent/associate companies; in particular, risk surcharges are not levied for group internal financial relations if the third-country law is equivalent to that of the European Union.³⁹

In corporate law, the principle of equivalence applies to the transparency duties of issuers, although not in statutory law, but through special recognition by public authorities. Within the scope of EU law, the publication of insider information in the United States is itself not sufficient, but must be accompanied by a publication that fulfills the requirements of the MAR. Similarly, a takeover bid in the United States may have to comply with the conditions of the Takeover Directive,⁴⁰ which are different. Beneficial ownership disclosure and financial reporting under US securities law do not, in principle, satisfy the requirements of article 9 and others of the Transparency Directive. However, the competent authority can exempt a shareholder from the duties of the Transparency Directive if the third-country law provides for equivalent requirements.⁴¹

Requirements

Establishing equivalence requires three conditions with differing goals. The requirement of equivalence protects investors and the financial system against risks created by insufficiently regulated or supervised market participants. The requirement of reciprocity creates a level playing field, allowing EU intermediaries the same market opportunities as intermediaries from third countries. The requirement of cooperation in fighting money laundering, terrorism financing and tax evasion protects important public interests, such as security and the functioning of social security systems.

33 AIFMD, *supra* note 9, arts 36–42; Dirk Zetzsche & Thomas F Marte, “AIFMD versus MiFID II/MiFIR: Similarities and Differences” in Zetzsche, AIFMD, *supra* note 23 at 458.

34 MiFID II, *supra* note 9, arts 19(6), 24(4); MiFIR, *supra* note 9, arts 46–47.

35 EMIR, *supra* note 9, arts 25, 75 et seq.

36 Credit Rating Agency Regulation, *supra* note 18, art 5(6).

37 CSDR, *supra* note 12, arts 25(1), 9.

38 Cf Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance, [2009] OJ, L 335/1, art 172 et seq [Solvency II].

39 Cf CRD IV, *supra* note 9, arts 119 et seq, 127; CRR, *supra* note 9, arts 114(2), 115(4), 116(5), 405, 406; Solvency II, *supra* note 38, arts 135, 172 et seq, 227, 232. Zetzsche, “Drittstaaten”, *supra* note 10 at 75 et seq; Dirk Looschelders & Lothar Michael, “Europäisches Versicherungsrecht” in Matthias Ruffert, *Enzyklopädie Europarecht vol 5 – Europäisches Sektorales Wirtschaftsrecht* (Baden-Baden, Germany: Nomos, 2013), § 11 at para 65.

40 Takeover Directive, *supra* note 8.

41 Transparency Directive, *supra* note 8, art 23(1).

Equivalence of Law and Supervision

First, the law and supervision must be equivalent; in other words, the functionally comparing third-country legal regime must be at least as effectively enforced as its EU counterpart.⁴² The European Union has centralized essential parts of financial market regulation and supervision.⁴³ That also concerns the equivalence assessment: the European Supervisory Authorities (ESAs) — the European Banking Authority, the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority — as well as the European Commission have been declared exclusively competent for establishing third-country equivalence in some, but not all, areas.⁴⁴ This is a matter of sound economic policy: smaller member states would be disadvantaged in bilateral negotiations over market access with big third countries, while larger member states might try to take advantage of their superior market power. However, in some areas member states are either exclusively competent, or competent in the absence of the European Commission's equivalence assessment;⁴⁵ in this case, the ESAs must merely be informed about bilateral arrangements with third countries.⁴⁶ Where member-state authorities have such powers, a certain degree of regulatory arbitrage or political interference may be expected, depending on the member states' interests.⁴⁷ This is particularly true because the equivalence mechanism embedded in many EU legislative acts is as yet little tested in practice.

The term “equivalence” is a flexible one and subject to interpretation. It lends itself as a

bargaining chip in political negotiations.⁴⁸ For instance, Switzerland was at first denied the equivalence of its clearing system after it had restricted the free movement of EU workers. This ultimately caused the Swiss to change their legal framework.⁴⁹

According to the European Commission, when taking decisions on equivalence, it exercises discretion; while it takes into account the goals of promoting the internal market for financial services and the protection of financial stability and market integrity, it also needs to factor in wider external policy priorities and concerns.⁵⁰ As a consequence of this view — assuming that it is correct — there would be no legal remedy against equivalence decisions; European Union and third-country intermediaries that are allegedly disadvantaged could not ask a court to review the decisions. For instance, an EU intermediary could not challenge the ESMA decision granting Switzerland and the United States equivalence status under the AIFMD, although the liability for assets in custody under Swiss and US law is limited to fault and is not strict liability, as it is under EU law. This difference results in serious cost advantages compared with EU custodians, yet, according to the European Commission, it cannot be remedied in court. Neither can an EU firm challenge the fact that Swiss and US collective investments managers are subject to less stringent requirements of their remuneration system than are those of EU alternative investment fund managers (AIFMs). Conversely, an asset manager from Hong Kong cannot request access to the Single Market by arguing that he or she is subject to equivalent regulation at home.

Reciprocity

The second requirement for access to the Single Market is reciprocity; in other words, the EU intermediaries must be permitted to offer their services in the third country.⁵¹ This criterion is

42 Cf *Credit Rating Agency Regulation*, supra note 18, art 5(6); *CSDR*, supra note 12, art 25(9); *EMIR*, supra note 9, arts 25(2)(b), 25(6); *MiFIR*, supra note 9, arts 28(4), 47(1); *Prospectus Directive*, supra note 8, art 4(1)(3); *Short-selling Regulation*, supra note 8, art 7(2).

43 On EU external competence with regard to financial services, see Zetzsche, “Drittstaaten”, supra note 10 at 66 et seq; Zetzsche & Eckner, supra note 13, § 7A at para 58 et seq. Generally, the conclusion of a free trade agreement by the European Union requires consent by the member states; see ECJ, Opinion 2/15 of 16 May 2017.

44 Cf *MiFIR*, supra note 9, arts 28(4), 33(2) (trading venues), 38(1) (CCPs), 47(1) (securities firms); *Credit Rating Agency Regulation*, supra note 18, art 5(6); *CSDR*, supra note 12, art 25(9); *EMIR*, supra note 9, arts 25(6) (CCP), 75 (trade repositories); *Financial Statements Directive*, supra note 30, recital 50, art 47. Cf also *Prospectus Regulation*, supra note 8, art 29(3); *AIFMD*, supra note 9, art 67(2).

45 See Wymmersch, supra note 27 at 3 et seq.

46 See e.g. *Transparency Directive*, supra note 8, art 25(4).

47 See Wymmersch, supra note 27 at 36 et seq.

48 Cf Zetzsche, “Drittstaaten”, supra note 10 at 54 et seq, 127 et seq.

49 Cf European Commission, Press Release, “European Commission welcomes progress in relations between the European Union and Switzerland” (22 December 2016).

50 Cf European Commission, “Commission Staff Working Document – EU equivalence decisions in financial services policy: an assessment” (27 February 2017) SWD(2017) 102 at 9 et seq. In favour of a possible judicial review *de lege ferenda*, Zetzsche, “Drittstaaten”, supra note 10 at 127, 136; Moloney, “Brexit, the EU and its Investment Banker”, supra note 27).

51 Cf Zetzsche, “Drittstaaten”, supra note 10 at 62 et seq.

designed to level the competitive playing field. The European Union will open its market for the firms of another country only where foreign firms enjoy access to the market of the country in question. This avoids a situation in which European firms would have to deal with foreign competitors at home while not being able to compete with them on foreign markets. It is also an indirect tool to overcome entry barriers and the protectionist attitudes of some states.

The reciprocity criterion is, however, supported not only by the economic concern for a competitive level playing field, but also by the aim of avoiding an externalization of risks. As the service provider reaps the benefits, and the clients bear the risks of financial products, supervisors of the state of origin have little incentive to care for legal obedience of the service providers in the state of distribution. The situation is different if the risks are distributed symmetrically. The more likely it is that the risk will materialize in the firm's home state, the higher will be the willingness of the latter's financial authorities to cooperate.⁵²

The reciprocity requirement has an impact especially on the relationship between the European Union and the United States. While the ESMA has, in principle, categorized the US legal framework and the supervision concerning AIFMs as being equivalent to their EU counterparts, the US-substituted compliance is restricted to the domain of derivatives and does not encompass investment funds.⁵³ As a consequence, managers of hedge or private equity funds may offer their products in the United States only with a separate US authorization. A logical reaction by the European Union would be to refuse US investment managers access to the Single Market.

52 Cf *ibid* at 60 et seq; Zetzsche, "Competitiveness", *supra* note 27 at 398 et seq.

53 Cf ESMA, "ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs" (12 September 2016) ESMA/2016/1140 at 26 ("ESMA is of the view that the market access conditions which would apply to U.S funds dedicated to professional investors in the EU in the event that the AIFMD passport is extended to the U.S would be different from the market access conditions applicable to EU funds dedicated to professional investors in the U.S. This is due to registration requirements under the U.S regulatory framework [which generate additional costs], and particularly in the case of funds marketed by managers involving public offerings").

Anti-money Laundering/Counter-terrorism Financing Rules and Tax Transparency

A further requirement is that the home country must comply with the regulation of money laundering and tax transparency. Specifically, it must not be part of the "blacklist" published by the Financial Action Task Force (FATF). It must also comply with the standards of the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital, and it must guarantee an effective information exchange in taxation matters according to article 26 of that convention.⁵⁴

Legal Consequences

Once the aforementioned requirements are established, supervisory cooperation agreements are negotiated and approved either by the member states⁵⁵ — under coordination by the ESAs⁵⁶ — or by the ESAs themselves for legal areas for which they are directly competent.⁵⁷ This is followed by the recognition of the third-country intermediary by the competent authority. As far as the European financial market infrastructure is concerned, this authority is normally the ESMA⁵⁸ and, otherwise, the national authority in the intermediary's member state of reference.

On this basis, service providers from third countries can be granted a kind of European "passport" that is valid for the entire Single Market, allowing direct access by way of cross-border service or through the establishment of a branch offering services to professional customers and investors.⁵⁹ Member states may

54 *AIFMD*, *supra* note 9, arts 37(7)(e), 37(7)(f). Cf Zetzsche & Marte, *supra* note 33 at 463–65.

55 *Market Abuse Regulation*, *supra* note 8, art 26(2).

56 *Ibid*, art 26(1); *Prospectus Regulation*, *supra* note 8, art 30.

57 Cf for ESMA, *CSDR*, *supra* note 12, art 25(10); *Credit Rating Agency Regulation*, *supra* note 18, arts 4(3)(h), 5(7); *EMIR*, *supra* note 9, arts 25(7) (CCP), 76 (trade repositories); for the European Central Bank (ECB) in the context of its supervision of significant banks, *Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities*, [2014] OJ, L 141/1, art 8.

58 Cf *CSDR*, *supra* note 12, art 25(6); *Credit Rating Agency Regulation*, *supra* note 18, art 5(6); *EMIR*, *supra* note 9, art 25 (CCP), 77(1) (trading repositories). On third-country CCP and trade repositories, Olaf Achtelek, "Zulassung und Anerkennung von CCPs" in *Wilhelmi*, *EMIR*, *supra* note 28 at 250 et seq; Dominik Zeitz, "Zulassungsverfahren für Transaktionsregister" in *Wilhelmi*, *EMIR*, *supra* note 28 at 333 et seq.

59 *MiFIR*, *supra* note 9, art 47(3).

neither provide for additional requirements nor attempt to attract third-country companies by offering any privileges.⁶⁰

ESMA keeps a register of all third-country corporations. Registration can be revoked if a corporation acts against investor interests in the European Union, if it threatens the functioning of the market or if there is evidence of “serious” infringements of the law of its state of origin.⁶¹

Contractual Obstacles Affecting Access via the Principle of Equivalence

The equivalence test operates on the level of interstate relations. In addition, third-country corporations must observe special duties when concluding a contract with an EU customer.

Information Duties

Third-country financial firms must inform their EU customers that they are not permitted to provide services for other customers other than eligible counterparties or professional clients (article 46[5][1] of the MiFIR). The purpose of this information duty remains unclear, the third-country passport being restricted anyway to eligible counterparties and professional clients. Probably the customer must assess whether it belongs to the target group, but this does not spare the third-country provider from making its own assessment. In case it does offer services to other than qualifying parties, the third-country provider risks sanctions by the EU supervisor, including the revocation of registration as a third-country corporation under article 46(5) of the MiFIR. Yet, this should be the *ultima ratio* and applies only in cases of serious and systematic infringement.⁶² Private law consequences are doubtful. A right to damages⁶³ will rarely apply, as a violation of this information duty will hardly ever result in economic loss. Other private law consequences — for instance, rescission due to violation of pre-contractual duties could be considered — but the information and, accordingly, the infringement

is of little importance, so that rescission is excluded, for instance, under German law⁶⁴ (see German civil code [BGB], § 323 at para 5).

Obligatory Offers for Dispute Settlement

According to article 46(6) of the MiFIR, a third-country corporation must, before performing its services for EU clients, offer to submit potential disputes in relation to its services to an EU/EEA court or arbitral tribunal. With this requirement, EU clients are protected from the need to go to a third-country court in order to have access to justice.

The scale and consequences of this provision are again doubtful. Some authors have interpreted it as meaning that choice-of-forum clauses in favour of third-country courts will no longer be permitted in financial service contracts with EU clients and will therefore be void after Brexit.⁶⁵ This construction fails to convince because the text requires the third-country corporation only to “offer” the dispute settlement before the court or arbitrator of a member state. This leaves open the possibility that, after such an offer is made, the parties decide for a third-state court or arbitrator.

The consequences of a violation of the duties arising from article 46(6) of the MiFIR are also uncertain. In particular, it is unclear whether the failure of the third-country service provider to offer dispute resolution via a court or an arbitral tribunal in a member state would result in any jurisdiction or arbitration clause in favour of a non-member state being void. It is true that according to article 25(1) of the Brussels Ia Regulation, choice-of-forum clauses are inoperative if they are null and void as to their substantive validity under the law of the chosen court. It is also true that article 2(3) of the New York Convention does not recognize arbitration agreements as far as they are “null and void,

⁶⁰ *Ibid*, art 46(3).

⁶¹ *Ibid*, arts 48–49.

⁶² Jochen Eichhorn & Ulf Klebeck, “Drittstaatenregulierung der MiFID II und MiFIR. Aufsichtsrecht” (2014) 7 *Recht der Finanzinstrumente* 1 at 6.

⁶³ See *MiFID II*, *supra* note 9, art 69(2)(3).

⁶⁴ See in German law: BGB, §§ 323(1), 323(2)(3), 323(5)(2).

⁶⁵ See Burkhard Hess & Marta Requejo-Isidro, “Brexit – Immediate Consequences on the London Judicial Market” (24 June 2016), *Conflict of Laws.net* (blog), online: <<http://conflictoflaws.net/2016/brexit-immediate-consequences-on-the-london-judicial-market/>>.

inoperative or incapable of being performed.”⁶⁶ Arguably, however, these provisions presuppose voidness in terms of private law. Article 46(6) of the MiFIR is part of regulatory public law, so that an infringement does not per se result in the voidness of the dispute resolution clause in the sense of private law. Such voidness would be contrary to the interests of the EU clients that the provision aims to protect. They would be deprived of the possibility of invoking the choice-of-forum or arbitration clause against the third-state company. They may also fall victim to judicial conflicts between member-state courts and courts in third states that consider the dispute resolution clause as being valid. It is likely that courts outside the member states will not regard the agreement as null and void because of its violation of an EU regulation.

It is also not clear what is meant by “arbitral tribunal in a Member State” in article 46(6) of the MiFIR. *Per definitionem*, an arbitral tribunal does not belong to a state or member state. Yet, its seat may be located in a member state. This seat is to be distinguished from the arbitration institution that organizes the arbitration proceedings. If it is correct that (only) the arbitral tribunal must be based within the European Union, it would still be possible to have the proceedings organized by a third-state arbitration institution, such as the London Court of International Arbitration.

The matter is taken even one step further by article 37(13)(2) of the AIFMD. It requires that all disputes arising between the AIFM or the AIF and EU investors of the respective AIF have to be settled according to the law of an EU/EEA member state and are subjected to its jurisdiction. The wording of this provision differs from that of article 46(6) of the MiFIR in several ways. It refers not only to jurisdiction, but also to the applicable law. Moreover, it is not confined to the necessity that an offer has to be made by the third-state company, but imposes the law of a

member state and its jurisdiction as mandatory. In fact, the provision could be regarded as usurping, if it is understood as requiring that EU law and member-state courts should keep the upper hand over any dispute with EU clients.

Whether this strict consequence is intended remains uncertain, however. Hermeneutical difficulties start with the question of which member state the provision targets. Due to the lack of a definition in article 37(13)(2) of the AIFMD, one may speculate whether the member state should be determined by choice or in a different way, and in which way. The mandatory statutory determination of applicable law and jurisdiction would also be contrary to the general rules of EU private international law, which regularly allow the parties in business-to-business (B2B) relations to autonomously choose both the law and the court.⁶⁷ Finally, under a literal interpretation of the text, arbitration agreements envisaging a seat outside of the European Union would be void. This would mean nothing less than a blunt interference with the general principles of international arbitration. One may doubt whether the drafters of the AIFMD, who were most likely experts in financial but not in private international law, intended these outcomes or were even able to anticipate the problems.

Article 37 of the AIFMD was adopted earlier than article 46(6) of the MiFIR. The choice granted to EU customers by the latter seems to capture the intention in a more precise way than article 37(13)(2) of the AIFMD. One reasonable interpretation is, therefore, that the provision requires merely the offer of EU law and a member-state court, even though it must be admitted that the wording does not reflect this intention in an adequate manner.

Recognition of Judgments and Applicable Law

The fate of the Rome Regulation and the Brussels Ia Regulation after Brexit is far from clear.⁶⁸ The worst-case scenario would be that from March 30, 2019, and onwards the United Kingdom would have to be regarded as a third country in terms of private international law. This would

⁶⁶ *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 UNTS 38, 21 UST 2517, 7 ILM 1046, art 2(3) (entered into force 7 June 1959). Although a similar clause is missing, the situation is not different under the Lugano Convention: *Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters*, 16 September 1988, 28 ILM 620 (entered into force 1 January 1992); see Domenico Acocella, “Commentary on Art. 1-4, Vorbem. zu Art. 2, 5 Nr. 1-3, 18-21, 31, 57-58, 62 LugÜ” in Anton K Schnyder, ed, *Lugano-Übereinkommen zum internationalen Zivilverfahrensrecht* (Zurich, Switzerland: Schulthess, 2011), art 1 at paras 72, 133; Rainer Hausmann in Thomas Simons & Rainer Hausmann, ed, *Brüssel Ia-Verordnung* (Munich, Germany: IPR-Verlag, 2012), art 1 at para 110.

⁶⁷ For details, see Dirk Zetzsche, “Das grenzüberschreitende Investmentdreieck” in Zetzsche & Lehmann, *Finanzdienstleistungen*, supra note 32 [Zetzsche, “Investmentdreieck”].

⁶⁸ Matthias Lehmann & Dirk Zetzsche, “Die Auswirkungen des Brexit auf das Zivil- und Wirtschaftsrecht” (2017) 72 *Juristenzeitung* 62 at 63 et seq [Lehmann & Zetzsche, “Die Auswirkungen des Brexit”].

make the enforcement of British court decisions much more difficult on the Continent.⁶⁹ For third-country companies, it would no longer be attractive to agree on the jurisdiction of British courts when contracting with EU customers. The lack of enforceability of British judgments in the European Union would probably be compensated through market mechanisms, for instance, through higher prepayments or margin payments. Both measures would make British legal services more expensive compared with those of EU competitors, as more capital or collateral would have to be provided for those transactions when compared to those where the recognition and enforcement of judgments is supported by harmonized European private international law and European civil procedure rules. Seizing a British court would still make sense for British financial service providers in defence against claims by EU customers. The possibility that a British court decision rejecting such claims might lack recognition in the European Union will not be detrimental if the British service provider has concentrated its assets in the United Kingdom.

Prospectuses and key investor information documents regularly contain references to the applicable law and jurisdiction.⁷⁰ Although so far, this reference serves merely a declaratory purpose, it may in the future become much more valuable and operate as the choice of law and court. The same applies to agreements designed to comply with provisions of the EU financial markets law requiring choice of law and court to be expressed in contracts.⁷¹ Normally, these provisions do not require the choice of a certain court or law so that third-country courts and jurisdictions can be chosen. However, the effectiveness of such agreements would have to be reviewed against the background of EU law in general. For example, European private international law provides for a special role of court and jurisdiction

at the consumer's habitual residence.⁷² British law might in the future depart from this view in a biased attempt to promote British service providers. This shows that it would be desirable also from the EU point of view to maintain the status quo of judicial cooperation in private international law.⁷³ However, in pursuing this goal the competence of the Court of Justice of the European Union (CJEU) to interpret European law is a pill that the British side will hardly be prepared to swallow in the Brexit negotiations.

Smaller obstacles are created by European financial markets law, where it abstains from regulating an issue and instead refers to member-state law. An example is article 11(2) of the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation⁷⁴ on liability arising from a particularly faulty key information document. Terms such as "loss" or "damages," as used in this regulation, are to be interpreted and applied in accordance with the national law determined under the general rules of private international law (article 11[3] of the PRIIPs Regulation). After Brexit, the PRIIPs Regulation will no longer apply to the United Kingdom. It has to be assumed, though, that the regulation will continue to apply to already existing claims, and also that the EU rules of private international law apply.

Consequences

On the basis of equivalence decisions, UK companies will still be able to offer services and product delivery to professional counterparties and investors in the B2B reinsurer market, in the area of central financial market infrastructure and in capital and funds management for professional counterparties. This explains why alternative funds managers (hedge funds and private equity) in London make little effort to secure EU market access. As long as the United

69 *Ibid* at 62 et seq.

70 See UCITS Directive, *supra* note 9, Annex I, No 3.2; AIFMD, *supra* note 9, art 23(1)(c).

71 See e.g. Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries, [2016] OJ, L 78/11, art 2(5) for the contract between the management company and the depositary of a fund. For details, see Zetzsche, "Investmentdreieck", *supra* note 67.

72 Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, [2008] OJ, L 177/6, art 6; Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, [2012] OJ, L 351/1, art 17 et seq [Brussels Ia Regulation].

73 See Lehmann & Zetzsche, "Die Auswirkungen", *supra* note 68 at 62, 64 et seq.

74 Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), [2014] OJ, L 352/1.

Kingdom does not completely change its law after Brexit, an equivalence decision should be within reach, provided that the United Kingdom in return grants market access to EU companies. The equivalence status might be threatened, though, if the British government decides to lower its standards in the area of money laundering and taxation cooperation. At present, this is not to be expected, as the United Kingdom has vested interests in a solid taxation basis and global coordination in the area of taxation. The same applies for financial market infrastructure. Changes may occur in clearing and settlement if — as it currently seems — the ECB will be successful in its plan to move euro clearing from the United Kingdom to the euro area.⁷⁵

By contrast, the equivalence of law and supervision will not help banks and primary insurers much. This makes it invariably necessary for banks and insurers to establish independent subsidiaries in EU member states or subsidiaries to conduct business in the European Union;⁷⁶ this is a requirement from which especially France, Germany, Ireland, Luxembourg and the Netherlands will probably benefit.⁷⁷

EU Subsidiary

British financial service providers could decide to offer services to EU clients through an EU subsidiary that is legally independent in terms of corporate law and supervision. This could be an interesting option, since a fully equipped and licensed EU subsidiary can exercise the freedom to provide services according to article 56 of the Treaty on the Functioning of the European Union *ex origine*; it can claim the benefits of the EU passport system and stay, or become even closer, to clients located in the European Union.

75 Cf EC, Directorate-General for Internal Policies of the Union, *supra* note 7 at 46 et seq.

76 In the same sense, Heinrich Nemeček & Sebastian Pitz, “The Impact of Brexit on Cross-Border Business of UK Credit Institutions and Investment Firms with German Clients” at sub 6 (“Conclusion”), online: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2948944>; Norman Mugarura, “The ‘EU Brexit’ implication on a single banking license and other aspects of financial markets regulation in the UK” (2016) 58:4 Intl J L Mgmt 468.

77 Cf André Sapir, Dirk Schoenmaker & Nicolas Véron, “Making the best of Brexit for the EU27 Financial System” (2017) Bruegel Policy Brief Issue 1 at 1.

At the same time, there are various means to reduce double costs. For instance, the group could benefit from a close interrelationship with the parent or sister companies in the same group through savings of prudential capital by booking transactions outright in group companies (“remote booking”) or, at least, through hedge transactions using group companies as counterparties, such as by virtue of intragroup hedging through back-to-back hedges or split hedging arrangements where some sister (specialist) companies take certain (for example, currency) risks; for instance, a Japanese sister company may take all yen risks, while the Hong Kong sister company takes all Hong Kong dollar risk and so on. Another idea that could result in cost savings is dual hatting, in which one fit and proper officer has multiple offices in the subsidiary, sister and parent companies. Or the group of companies seek to benefit from lower overall capital requirements by internal risk models that assume full group integration, for instance, by netting positions of parent, sister and EU-subsidary companies.

Shareholder Vetting

Companies from third countries will be licensed in the European Union only after they have been thoroughly checked for any influence that could endanger the enforcement of European financial markets law.⁷⁸ Shareholders from countries notorious for corruption or for supporting terrorism give cause for concern, as do those that might withdraw customers’ or equity assets from the EU subsidiary. Such danger should not arise with regard to British investors, as long as the United Kingdom maintains supervisory standards that are identical to EU law. The problem is that many intermediaries from countries outside the European Union used to organize their EU business via London. If this is to continue, the EU supervisory authorities will often have to look through the UK corporation in order to identify detrimental influences from third countries. However, banks and insurers from Asia and the United States may in the future take the direct route and hold shares in EU subsidiaries themselves.

78 Cf CRD IV, *supra* note 9, art 14(3); MiFID II, *supra* note 9, arts 10(1), 10(2); AIFMD, *supra* note 9, art 8(3)(b); a similar practice exists with regard to insurance companies under Solvency II, *supra* note 38, art 24. See Zetzsche, “Drittstaaten”, *supra* note 10 at 72 et seq.

More obstacles are looming on the horizon. Under some investment laws, third-country shareholders may be banned for public policy reasons (see, for example, sections 2[2], 5[2] of the German Foreign Trade and Payments Act). Where a shareholding conveys a “definite influence” on corporate governance, the CJEU reviews such laws exclusively against the freedom of establishment, which is limited to member states of the European Union and EEA, and not against the freedom of capital, which is open to third countries.⁷⁹ These laws will therefore be applied in their full breadth to the United Kingdom once it has become a third country.⁸⁰ Even though nobody will regard the United Kingdom as a rogue state or an enemy, mergers and acquisitions between EU and British companies will take longer, as the recently prolonged auditing phase for takeovers illustrates.⁸¹ Any delay in the sensitive transaction phase may, of course, create serious havoc.

Letter-box Companies

British companies could be tempted to avoid the complex transfer of staff, customers and offices by using EU subsidiaries that delegate the main services back to the UK parent. If the subsidiary is only minimally equipped, value creation will still mainly occur in the United Kingdom. Alternatively, British companies could transfer “secure” business to a registered EU intermediary, which then outsources or delegates some business back to the UK entity. Both strategies are possible because the legal framework of outsourcing is not fully harmonized; the European Union has adopted only some legal instruments concerning outsourcing on the financial market.⁸² As a result, a competition seems to be developing between EU member states, which vie with each other to attract British subsidiaries (or branches in the area of MiFID II) by offering low requirements for capital, staff and material equipment.

In this context, ESMA has reminded member states of the need for the uniform application

of EU law and of avoiding regulatory and supervisory arbitrage.⁸³ In particular, ESMA warns against too generous outsourcing to British headquarters, which enables the creation of letter-box companies from which the whole EU market is served. The warning is important, considering ESMA’s coordinating function in applying the law and its power to solve disputes between national supervisors, especially in the area of asset management and market infrastructure.⁸⁴ Indeed, a race to the bottom with regard to substantial requirements would not only be detrimental for the national economy, but it would also undermine the efficiency of supervision if subsidiaries are so poorly equipped by their parents that the supervisory or resolution authorities cannot access assets and business links in a crisis.⁸⁵ The personnel of the subsidiary must be capable of coping with the subsidiary’s operative business, as well as providing its internal control system (comprising compliance, risk management and internal audit⁸⁶) independently of the parent company.⁸⁷ In addition, the efficient enforcement of EU law requires that the branch’s data and servers work independently of the parent company and keep functioning in case of a breakdown in the parent company. This implies the need for a suitable hierarchy of reading and editing rights, a diversified selection of providers, as well as operation guarantees bespoke to EU countries, for instance, in the area of cloud computing.

79 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* (2006), C-196/04, ECR 2006, 7995 (CJEU) at para 31 et seq.

80 *Accord Poelzig & Bärnreuther*, *supra* note 3 at 157 et seq.

81 See from a German perspective, Christoph H Seibt & Sabrina Kulenkamp, “CFIUS-Verfahren und Folgen für M&A-Transaktionen mit Beteiligung deutscher Unternehmen” (2017) 39 *Zeitschrift für Wirtschaftsrecht* 1345.

82 See Zetzsche, “Drittstaaten”, *supra* note 10.

83 Cf ESMA, “General principles to support supervisory convergence in the context of the UK withdrawing from the EU”, 31 May 2017, ESMA42-110-433.

84 Cf *Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)*, amending *Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC*, [2010] OJ, L 331/84 [ESMA Regulation], art 19; Zetzsche & Eckner, *supra* note 13, § 7A at para 92 et seq; Zetzsche & Preiner, *supra* note 13, § 7B at para 105.

85 For more details, see Zetzsche, “Drittstaaten”, *supra* note 10 at 87 et seq.

86 Cf *MiFID II*, *supra* note 9, arts 16(2), 16(5); *Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive*, 31 March 2017, [2017] OJ, L 87/1, arts 22–24 (entered into force 20 April 2017).

87 ECB, “Relocating to the euro area” [2017], online: <www.bankingsupervision.europa.eu/banking/relocating/html/index.en.html> (“Banks in the euro area should be capable of managing all material risks potentially affecting them independently and at the local level, and should have control over the balance sheet and all exposures”).

Bilateral Market Access

As an alternative to equivalence-based access or the establishment of an EU subsidiary, third-country companies may opt to offer financial services in the European Union on the basis of a national licence. The companies could then access the market via cross-border offerings or via the establishment of dependent EU branches.

Bilateral Agreements of Market Access

For banks and primary insurers, the supervisory authorities of the EU member states are authorized to grant market access for their own territories. The EU member states also have the power to grant third-country providers market access for their territories under certain conditions, which are similar to the EU “third-country passport.”⁸⁸

This way may seem attractive to the United Kingdom, which in the past has often favoured a “divide and rule” strategy. However, the British government would have to deal separately with the 30 countries (27 remaining EU member states and three EEA members) and would be dependent on the decisions of their administrations. Such decisions might well be influenced by bilateral political conflicts, for instance, in the relationship with Spain by the status of Gibraltar and fishing rights in the North Sea, in Visegrad countries by the treatment of immigrants in Britain and so on. Linking market access with problematic areas of foreign policy is a no-go for financial intermediaries: in particular, the subsidiaries of US banks that are at present very active in the United Kingdom might prefer to access the EU Single Market directly from New York.⁸⁹

Bilateral Market Access Based on MiFID II/MiFIR

Recent financial market reforms in the European Union have restricted national discretion on market access by establishing uniform access

conditions. The MiFID II and MiFIR grant third-country service providers limited access to retail clients. A precondition is that essential conditions for the equivalence decision of the European Commission are fulfilled; these pertain to third-country registration and supervision, initial capital, participation in an investor protection system, consideration of FATF recommendations, cooperation agreements and tax transparency. Only the formal requirement of equivalence and its statement by the European Commission with regard to the law and supervision are missing. Without an EU equivalence decision, member states are able to maintain market access for traditionally close trade partners without the participation of EU authorities, which might benefit Britain.⁹⁰ Access could be achieved by establishing a branch or by cross-border trading.

Establishing a Branch

Member states are free to require that third-country service providers wishing to serve retail clients in their territory establish a branch in their country. Such a branch would not be granted an EU passport, meaning that it could only provide its products and services in the member state in which it had been established. For other member states, the third-country provider must observe the respective national requirements, including the establishment of an additional branch. The multiplication of national establishments would make access to the entire Single Market via dependent branches expensive and unattractive. British companies would probably concentrate on the markets of a few large member states.

Member states can decide on the operational conditions of the branch under articles 39 to 41 of the MiFID II. According to the same provisions, they are also free to grant market access without the establishment of a branch. The background of this latitude is a compromise between the European Commission and the European Parliament, on the one hand, and the member states, on the other hand: while the European institutions advocated for the general extension of EU equivalence requirements to retail clients, member states insisted on the need for autonomous national criteria, especially with regard to the requirement of a branch.⁹¹ It should

88 Cf CRD IV, *supra* note 9, recital 23; *Solvency II*, *supra* note 38, art 162(2); Zetzsche, “Drittstaaten”, *supra* note 10 at 99 et seq; André Prüm, “Brexit: Options for Banks from the UK to Access the EU Market” (2017) European Banking Institute Working Paper Series 2017 No 7 at 3 et seq.

89 Armour, *supra* note 7 at 54 et seq.

90 *MiFID II*, *supra* note 9, art 39(1).

91 See Sethe, “Drittstaatenregime”, *supra* note 27 at 620.

be noted that granting bilateral access might involve the loss of the third-country company's obligations arising from individual contracts.⁹²

Cross-border Trade/Correspondence Services

Where British companies are spared from establishing branches in a certain member state, they may provide financial services by way of cross-border trading. They will be able to maintain the common practice of contacting clients and giving investment advice over the phone, in writing or via online platforms that is currently allowed under EU law.⁹³ This will be the case, for example, in Germany, which does not require the establishment of a branch to service retail clients in its territory (see section 2[4] of the German Banking Act [KWG] and section 96 of the German Securities Act, as amended by the Second Financial Market Reform Act, which permit the German Financial Supervisory Authority [BaFin] to exempt third-country firms from mandatory organization required by these two acts, especially from the obligation to establish branches). The condition is that the company does not need supervision by BaFin because it is already supervised by the respective authority of its home country; the company must also fulfill the conditions of a statutory instrument adopted by the German Ministry of Finance (see section 53c of the KWG). If other member states also generously refrained from demanding the establishment of branches, market access under articles 39 to 41 of the MiFID II could become an attractive alternative to the EU passport in the area of investment services.

It remains to be seen how the member states and BaFin will chisel out the details of the legal framework for third-country access. In Germany, the text of section 53c of the KWG suggests that the conditions of the EU passport — equivalence of law and supervision, as well as reciprocity — also apply for market access to retail clients. This is understandable because, otherwise, risks would be imported and market opportunities would be given away. In addition, transactions between EU subsidiaries and parallel third-country branches should be

closely monitored to prevent the circumvention of EU capital and other requirements.

Passive Use of the Freedom to Provide Services

Third-country status does not prevent EU citizens from using their freedom to passively receive services.⁹⁴ This can be done by so-called reverse solicitation,⁹⁵ in which the customer approaches the company abroad, rather than the other way around. In this case, the supervisory and private law of the company's home country applies. The passive use of the freedom of services is a consequence of the territoriality principle that is basically undisputed and partly set out in the secondary law of the European Union.⁹⁶

Institutional Business

It is beyond doubt that EU citizens and companies may cross the border and order services by British providers in the United Kingdom. However, in contrast to the case of Switzerland, it is not to be expected that clients will travel to London with suitcases filled with cash. The London financial centre is dominant in the wholesale business with institutional clients; it is estimated that 90 percent of European institutional financial transactions take place in London.⁹⁷ This group of clients wants to be continuously counselled and taken care of, while the third-state company is interested in continually placing new derivatives and investment strategies with their customers.

⁹² See especially article 46 of the MiFIR, *supra* note 9.

⁹³ See Winfried Kluth in Christian Calliess & Matthias Ruffert, eds, *EUV/AEUV*, 5th ed (Munich, Germany: CH Beck, 2016), art 57 AEUV at para 32; Sethe, "Drittstaatenregime", *supra* note 27 at 617.

⁹⁴ See ECJ, *Luisi and Carbone v Ministero del Tesoro*, C-286/82, C-26/83, [1984] ECR 377 at para 10; *Decker v Caisse de maladie des employés privés*, *Kohll v Union des caisses de maladie*, C-120/95, C-158/96, [1998] ECR I-1831, I-1842 at para 29 et seq.

⁹⁵ Sethe, "Drittstaatenregime", *supra* note 27 at 621 et seq; Kluth, *supra* note 93, art 57 at para 30.

⁹⁶ Cf MiFIR, *supra* note 9, art 46(5)(3); MiFID II, *supra* note 9, art 42, which allow reverse solicitation and prohibit member states from imposing any limitations; see also Sethe, "Drittstaatenregime", *supra* note 27 at 621 et seq.

⁹⁷ Cf Sapir, Schoenmaker & Véron, *supra* note 77 at 1.

The German financial supervisor BaFin follows a lenient interpretation of the passive use of the freedom of services. According to its view, customer-initiated “beauty contests,” such as product offers to specific addressees or visits by sales staff of the third-state company to existing customers in Germany, would be covered.⁹⁸ This interpretation is favourable for British intermediaries engaged in this business. Large banks and investment firms probably have business contacts with almost every institutional investor. Where this is not the case, such contact could be arranged, if customers keep visiting the important financial centre of London several times a year. All in all, the marketing of new products to institutional clients will remain possible after Brexit, perhaps with a few restrictions. The estimate that 60 percent of the European institutional business will remain in London even after Brexit, therefore, does not lack plausibility.⁹⁹

Business with Retail Clients

The situation is different for business with retail clients.¹⁰⁰ Article 46(5)(3)(2) of the MiFIR and article 42(2) of the MiFID II restrict reverse solicitation: a customer-initiated approach does not entitle the third-country company to market *new* categories of investment products or securities services, if the customer has not explicitly ordered them. This makes it more difficult to reach retail clients, which may include high net worth individuals or smaller family offices.¹⁰¹ This is why it will be necessary to define the limits of the passive use of the freedom of services, which are quite hazy in parts, for instance, in the marketing of funds shares.¹⁰² Do activities such as the reward-based

offer to EU banks and fund managers to join a marketing or an asset commission, the invitation of clients to sports events in the third country (with marketing intentions) or the publication of newspaper articles in the European Union constitute an extension of marketing activities to the European Union that requires the application of EU law? As long as these ambiguities exist, some British intermediaries will offer their services for EU customers in a grey area of law — just as some Swiss funds managers have done so far.

Conclusion

First, after Brexit, British issuers and financial intermediaries will be treated as being located in a third country. Regardless of the future status of the United Kingdom, UK financial intermediaries will be subject to those regulations of EU financial markets law that apply extraterritorially, covering countries with which EU intermediaries maintain financial trade relations.

Second, whether London can continue to fulfill a bundling function for the European business of many financial intermediaries from countries outside the European Union will depend on its future access to the Single Market. This access will most probably not be comprehensive. Rather, it will depend on the particular service or financial instrument offered, as well as the targeted customers.

Third, assuming that British regulation and supervision will be deemed to be equivalent to that of the European Union by a decision of the European Commission, UK firms will probably have market access in the area of public securities offerings, in the reinsurance business, in the area of market infrastructure and in funds management insofar as professional customers and investors are concerned. However, the situation will be different for the banking and primary insurance businesses and for all financial services offered to retail clients. This could prompt global banking and insurance firms to relocate their European hub from London to the Continent.

Fourth, experience with the recognition practice of third-country equivalence is still lacking in the area of the MiFID II and the AIFMD

98 Cf BaFin, “Merkblatt zur Erlaubnispflicht nach § 32(1) KWG und § 1(1) und (1a) KWG von grenzüberschreitend betriebenen Bankgeschäften und/oder grenzüberschreitend erbrachten Finanzdienstleistungen von April 2005”, online: <www.bafin.de>.

99 See Sapir, Schoenmaker & Véron, *supra* note 77 at 1.

100 The rule applies to all individual clients, whether or not they have chosen to be professional clients, in the sense of *MiFID II*, *supra* note 9, Annex II, s II.

101 Cf Dirk Zetzsche, “Family Offices und Familienvermögen zwischen Recht und Regulierung” (2017) 38 *Zeitschrift für Wirtschaftsrecht* 945; Dirk Zetzsche, “Family Offices und Familienvermögen zwischen Recht und Regulierung” (2016) 45 *Der Gesellschafter* 370; Dirk Zetzsche, “Family Offices und Familienvermögen zwischen Recht und Regulierung” in Susanne Kalss, Holger Fleischer & Hans-Ueli Vogt, eds, *Gesellschafts- und Kapitalmarktrecht in Deutschland, Österreich und der Schweiz 2016* (Tübingen, Germany: Mohr, 2017).

102 For details, see Dirk Zetzsche & Thomas Marte, “The AIFMD’s Cross-Border Dimension, Third-Country Rules and the Equivalence Concept” in Zetzsche, *AIFMD*, *supra* note 23 at 446 et seq.

(which are both important for the UK financial industry), but also in prospectus law and for shareholder transparency.¹⁰³ In spite of the European Commission's denial, political criteria may impact on the equivalence decisions. Further, as political decisions, equivalence assessments are not reviewable in court. As a result, UK financial services providers might be hanging in limbo for years.

Fifth, there is no EU passport for third-country companies in the area of banking and primary insurance business. This explains the hectic incorporation activities observed on the Continent since the United Kingdom has triggered the EU exit via article 50 of the Treaty on European Union. If the parent company is based in the United Kingdom, it is unlikely to move its headquarters into the European Union. In most cases, the parent company will try to establish a functionally independent, but minimally equipped, EU subsidiary, which takes advantage of the equivalence-based facilitation of capitalization and supervision.¹⁰⁴ This is why the question of minimal capitalization, staffing and equipment of EU subsidiaries (letter-box companies) deserves special attention by EU supervisors. In this area, crucial questions that need to be answered to achieve a harmonized approach include the availability of intragroup booking, hedging and risk calculation models, as well as the acceptance of dual hatting (in other words, officers functioning in more than one regulated entity at the same time).

Sixth, in the area of investment services to retail clients, member states retain some competences under articles 39 to 41 of the MiFID II. However, EU financial markets law requires third-country companies to fulfill a number of special and reporting duties in contract drafting. Questions of interpretation and application of these provisions, which so far have attracted little attention, are gaining in importance with Brexit and need to be clarified to allow for a smooth functioning of cross-border financial services.

Seventh, if EU investors make use of their right to receive services via reverse solicitation, the

business with institutional clients could continue from London with few restrictions. Given the little degree of harmonization in this area, and the EU regulators' push for a harmonized approach vis-à-vis third countries that Brexit has brought about, some uncertainty remains as to the long-term availability of a reverse solicitation model. Among others, reciprocity may be one of the factors determining the future trajectory.

¹⁰³ See also Armour, *supra* note 7 at 54 et seq.

¹⁰⁴ Cf for insurances, Solvency II, *supra* note 38, arts 135, 172 et seq, 227, 232; for banks, CRR, *supra* note 9, arts 107, 114, 115, 116, 132, 142; CRD IV, *supra* note 9, art 116.

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