Read this post online

Brexit: What future for MiFID II?

Countdown to Brexit started on March 29, 2017, date on which Theresa May officially notified the Chair of the European Council of the United Kingdom's intention to leave the EU. This notification launches two years of tough negotiations at the end of which the United Kingdom and the European Union must agree on the terms and conditions of UK's withdrawal, unless this timeline is extended by unanimous agreement from all EU Member States.

The timetable for negotiations coincides with the entry into force in 2019 of a series of financial rules, one of the most important in the banking and financial sector being the Directive on markets in financial instruments, known as the MiFID Directive. The implementation of this Directive is essential to allow banks and investment firms to operate within the European Union.

Directive 2004/39/EC on markets in financial instruments, known by its English acronym MiFID I, became effective on November 1, 2017. It was designed to create an integrated European financial market where the terms and conditions governing the provision of investment services in EU Member States would be regulated, in particular, to enhance investor protection and increase the competitiveness of EU financial markets.

When designing this Directive, the adoption of a second one aimed at correcting any potential deficiencies that would appear during the implementation of MiFID I had been envisaged. The 2008 financial crisis prompted the revision of MiFID I.

As such, Directive 2014/65/EU dated May 15, 2014 (known as MiFID II) and Regulation (EU) No 600/2014 dated May 15, 2014 (known as MiFIR) on markets in financial instruments aims at further improving the security, operation and transparency of financial markets for the public and further enhancing investor protection.

Regarding financial services, MiFID I, soon to be completed by MiFiD II, is an essential piece of legislation of the European Union inasmuch as it confers to financial institutions of a Member State the possibility to operate across Europe through the open sesame of “passport”.

This passport gives financial companies the right to provide financial services throughout the EU or in any Member State of the European Economic Area (“EEA”) under the license granted to them by their home country[1].

The biggest post-Brexit risk for financial institutions that use the United Kingdom as an entry point to EU markets is the loss of passporting rights. If the United Kingdom, leaving the EU, does not remain a member of the EEA (as suggested by Theresa May in her January 17, 2017 speech), it will become a “third country” within the meaning of MiFID.

As of today, third-country financial services companies that wish to operate in an EU Member State must be established as a licensed entity in the relevant Member State, as per the criteria applied by that State. However, it may, through the creation of a subsidiary in an EU Member State, rely on passporting rights to provide services from that country through the European Union. This is how North American or Asian firms currently operate on European markets through subsidiaries based in the United Kingdom.

MiFID II aims at creating a framework regulating the access of third-country firms to the EU market. As such, the delivery of authorizations to branches of an entity based in a third country will henceforth be made according to requirements uniformly applied throughout the European Union, without the possibility for Member States to impose any additional requirements (Article 41 of MiFiD II). In addition, an institution based in a third country will be entitled, without having to create a branch in a EU Member state, to serve business consumers insofar as the European Commission has adopted an equivalence decision concerning said third country, under which the regulations and supervision in that country as regards prudential requirements and conduct of business rules are of equivalent effect to the requirements under MiFID II (Articles 46 and 47 of MiFiD II).

The objective of this scheme is two-fold: ensuring that the European Commission has verified the equivalence of the prudential framework and conduct of business rules in third countries and guaranteeing a degree of protection comparable to that offered by financial institution established in a Member State.

The entry into force of MiFID II, initially scheduled on January 3, 2017, has been postponed by one year by the European Commission due to the complex technical infrastructure that needs to be set up and the high number of data to be collected by the European Securities and Markets Authority (ESMA) that supervises the orderly functioning of financial markets. As such, *national competent* authorities have until January 3, 2018 to comply with the provisions of the recast Directive.

Yet, while the withdrawal process has been officially launched, should we expect further upheavals in the timetable for the transposition of MiFID II? Even more radically, could the transposition in the United Kingdom be called into question by the British?

The answer is no, according to the Financial Conduct Authority (FCA)[2]. This British Authority made a statement on the day following the referendum on Brexit. It confirmed that the transposition of the Directive was still relevant and that firms ought to maintain the steps already taken to ensure compliance with the future framework. The Financial Conduct Authority indeed declared: "*Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect*".

In this context, can it be reasonably considered that as long as the United Kingdom will meet the requirements of MiFID, British financial institutions should be entitled to continue operating within the European Union through "equivalences". Theoretically yes, but one has to take into account the cumbersome procedure governing the grant of equivalences –designed out of the Brexit context – and the application process can take time in the context of the withdrawal timetable that has now started.

We cannot, therefore, rule out the possibility that relevant institutions, faced with the possible loss of their passporting rights, will anticipate the incorporation of subsidiaries in an EU Member State, without waiting for the outcome of the withdrawal negotiations.

[1] The European Economic Area (EEA) was set up in 1994 to extend the European Union's provisions on its internal market to the European Free Trade Area (EFTA) countries.

[2] The Financial Conduct Authority (FCA) is an independent public accountable to the Treasury and to Parliament. It is the conduct regulator for 56,000 financial services firms and financial markets in the UK; it is also the prudential regulator for over 18,000 of those firms.