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**THE ROLE OF THE EUROPEAN UNION
EQUIVALENCE REGIME IN
GLOBAL CAPITAL MARKETS**

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Submitted in fulfilment of the requirement for the Degree of
Doctor of Philosophy in Law
(PhD in Law)

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ABSTRACT

This thesis examines the European Union equivalence regime as a legal instrument and governance technique within the wider transformation of post-crisis international financial regulation. It argues that equivalence is not merely a technical market access mechanism, but a structured form of conditional reliance through which the European Union seeks to reconcile openness to cross-border finance with prudential control and regulatory projection.

The thesis argues that equivalence remains embedded in international technocratic governance, since its practical operation depends on shared standards, regulatory comparability, and repeated interaction within transnational networks. Within the EU legal order, the thesis demonstrates that equivalence is shaped by financial stability and by the logic of regulatory centralisation. Its design and operation vary across sectors according to differing assessments of risk, dependence, and prudential sensitivity, and equivalence contributes to the centralisation of supervisory authority at EU level, particularly through European Securities and Markets Authority. Externally, it argues that the Union's practice is shaped by financial stability and regulatory power projection, whose varying combinations generate integrationist, defensive, and negotiationist models. The China and Hong Kong case study further shows that equivalence may also operate through spatially mediated forms of regulatory connection. Overall, equivalence emerges as a differentiated mechanism for governing interdependence and promoting regulatory convergence after crisis.

Keywords: equivalence regime, European Union (EU) financial regulation, global financial governance, regulatory power, technocratic governance

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Per aspera ad astra.

AUTHOR'S DECLARATION

I declare that, except where explicit reference is made to the contribution of others, this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Additionally, I declare that ChatGPT 4.0/5.4 (OpenAI, <https://chat.openai.com>) was used solely as a tool for language polishing and footnote format checking in the preparation of this thesis. The originality of the ideas, arguments, and the selection and interpretation of research materials presented in this thesis are entirely my own. No AI tool was used to generate substantive content, develop original arguments, or introduce new research material.

All AI-assisted text-polishing was subsequently reviewed and further corrected by the author to ensure that the final text accurately reflects the author's intended meaning. I accept full responsibility for the authenticity, originality, and academic integrity of this thesis. All arguments developed in this work can be traced back to the author's research trajectory and draft materials produced over the course of four years of doctoral study.

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Date: 30 September 2025

INTRODUCTION

Research Context

In the contemporary globalised financial system, the speed and scale of cross-border flows of capital and financial instruments have expanded significantly, prompting long-standing calls for a more unified and coordinated global regulatory framework. At present, however, the architecture of international financial regulation relies primarily on a series of intergovernmental networks centred on soft law. The Group of Twenty (hereinafter G20) and the Financial Stability Board, the International Organization of Securities Commissions and similar frameworks exemplify how political consensus and technical expertise function as substitutes for enforceable international obligations. In sum, the international financial regulatory system is fundamentally marked by its reliance on soft law instruments and informal institutional arrangements rather than treaty-based hard law.

The governance framework has evolved incrementally and pragmatically, largely in response to major episodes of financial instability, rather than through a deliberate process of formal institution-building. This explains both the persistent institutional fragmentation and the predominance of regulatory standards without binding legal force, and the global financial regulatory order is distinguished from other domains of international law: authority is dispersed across overlapping networks of financial regulators, and compliance depends primarily on national political will and voluntary legal transplantation.

While this system has provided the flexibility necessary to respond to the dynamic and highly technical nature of global finance, it also generates inherent weaknesses, most notably the absence of effective enforcement mechanisms and the vulnerability of international standards to divergent domestic implementation. The 2008 global financial crisis further exposed the vulnerabilities of this soft law-based system. Following the outbreak of the crisis, the high degree of interconnectedness in global financial markets led to the rapid cross-border transmission of systemic risks. It became gradually more evident that traditional multilateral soft law intergovernmental networks were insufficient to cope with the highly interconnected and complex environment of global finance, and that stronger coordination mechanisms were required to foster deeper international convergence.

Prior to the crisis, international financial regulation was more strongly oriented towards market integration and financial liberalisation, while questions of financial supervision were largely left to individual jurisdictions and international arrangements remained primarily coordinative in nature. This structure allowed jurisdictions to retain the benefits of financial activity within their own borders while externalising a significant share of the resulting negative externalities to the global financial system. At the same time, many segments of the international capital market had long relied on industry self-regulation and market practices, with no unified cross-border coordination mechanisms or binding international rules. When the crisis struck, this institutional gap was quickly magnified, leaving national regulatory authorities to resort to emergency measures based solely on domestic laws and policy objectives. In the post-crisis period, financial stability became the central concern of global regulatory reform. Yet jurisdictions also increasingly resorted to the extraterritorial application of their own rules in order to protect domestic interests. Divergences in approaches and priorities across jurisdictions not only intensified the risks of regulatory divergence and market fragmentation, but also generated direct conflicts between regulatory regimes and undermined legal certainty for cross-border market participants.

It is against that double background that this thesis situates the significance of equivalence as a paradigmatic example of the deference model.. Equivalence operates as a intermediate mechanism embedded within existing framework, one that strengthens the practical enforceability of soft-law standards while tempering the disruptive consequences of unilateral regulatory assertion by major powers. It relies on the shared standards, professional understandings, and forms of comparability generated by international technocratic governance, while seeking to remedy the practical weakness of soft law by attaching more structured legal and market consequences to cross-border co-operation. The equivalence is therefore a structured mechanism of conditional and selective reliance through which the European Union seeks to manage openness to third-country markets while preserving prudential control, institutional authority, and regulatory autonomy.

In this thesis equivalence is situated within the wider transformation of EU financial regulation and global financial governance, and it is also examined as a key instrument through which the European Union redefines both its internal supervisory architecture and its external regulatory power. Before the European Union can project its regulatory

preferences externally, it must first construct regulatory coherence at the EU level. In this respect, equivalence has played an important role in supporting the development and consolidation of the Single Rulebook, helping to frame market access and third-country recognition within a more centralised and uniform EU regulatory order. This process of internal centralisation, in turn, has required the growing involvement of EU-level agencies. Accordingly, technocratic governance, represented most prominently by ESMA, occupies an important place within the operation of the equivalence regime, both as part of the Union's internal supervisory consolidation and as part of its external regulatory engagement.

The thesis as a whole makes three principal contributions. First, it re-situates equivalence within the broader transformation of post-crisis international financial governance and shows that it must be understood in relation to the soft-law and technocratic structures on which it depends. Secondly, it provides a more integrated account of the internal structure of the EU equivalence regime, demonstrating that the regime is fragmented, sector-specific, and risk-sensitive rather than uniform, and that financial stability and institutional centralisation are central to its operation. Thirdly, it offers a differentiated account of the Union's external use of equivalence by identifying its underlying policy drivers, developing a model-based framework for its external operation, and extending that framework to a relatively closed market setting in which mediated connection through a brokerage city becomes possible.

The broader claim running through the thesis is that equivalence is best understood as a multi-layered mechanism of managed reliance. It is embedded in international technocratic governance rather than replacing it. It operates internally through a differentiated and prudentially structured framework across EU financial legislation. It operates externally through both general and context-specific forms of conditional regulatory connection. The significance of the regime lies precisely in this combination. It links international soft structures, EU internal institutional development, sectoral differentiation, and external regulatory projection within a single governance framework.

Research Questions

The core research questions of this thesis are: What are the key features of the European Union equivalence regime and how does it link the European Union Single Market with global capital markets? In addressing this question, the thesis further examines the practical effects generated by the equivalence regime, both within the European Union itself and in its interactions with external jurisdictions.

From that starting point, the thesis proceeds through a deliberately ordered structure. It moves from the international background in which equivalence emerged, to the internal dimension of the regime within the EU legal order, and then to its external dimension in the Union's relations with third countries. This structure is central to the argument of the thesis. The chapters are not arranged as a series of detached topics. Each stage prepares the next, and the analytical progression reflects the nature of the subject itself. Once equivalence has been located within its wider international setting, the next task is to understand what kind of regime it is within the Union. Once its internal structure and differentiated operation have been examined, the final task is to understand how it is deployed externally. The thesis is therefore structured not merely by chapter sequence, but by a substantive movement from context, to regime, to application.

Chapter 1 establishes the international context. It traces the evolution of cross-border financial governance from pre-crisis soft-law coordination and technocratic standard-setting, through the post-crisis elevation of financial stability and the expansion of extraterritorial regulatory practices, to the emergence of deference as a means of reducing fragmentation while preserving prudential control. It also introduces the limited theoretical framework used in the thesis, drawing on constructivist and epistemic community perspectives to explain how international technocratic networks facilitate norm formation, comparability and the practical operation of managed reliance. This chapter therefore provides both the background and the conceptual location of the regime.

Chapter 2 then turns to the regime itself. It provides a general overview of equivalence as a legal and institutional mechanism within EU financial law and identifies its deeper structural logic. The chapter argues that equivalence is a fragmented, sector-specific and risk-sensitive framework of selective managed reliance. Chapter 2 also shows that financial stability is not simply an external policy concern occasionally invoked in the administration of equivalence, but a central force shaping the regime's structure,

boundaries, and operation. It also argues that the differentiated intensity of scrutiny across sectors is one of the clearest expressions of this logic. Even where equivalence is legislatively available, it is not administered uniformly. Different sectors attract different levels of procedural depth, supervisory involvement, and tolerance for divergence. Chapter 2 further shows that the regime is institutionally significant within the EU legal order because it contributes to the centralisation of authority at the EU level. The analysis of ESMA is tightly framed within the regime itself and shows how its four functions can be understood through both internal and external dimensions of technocratic governance.

Chapters 3 and 4 develop the sectoral analysis. Chapter 3 focuses on the principal equivalence regimes contained in European Market Infrastructure Regulation (EMIR) and Markets in Financial Instruments Regulation (MiFIR). It examines the most developed and operationalised forms of EU equivalence, including third-country CCP recognition, the dual-track access mechanism for third-country investment firms, and the more limited trading-venue dimension, and the regimes under EMIR and MiFIR are correspondingly shaped by concerns relating to infrastructural dependence, market functioning, and systemic exposure. Chapter 4 turns to a different group of sectors, including credit rating agencies, insurance undertakings, investment funds, and issuer disclosure frameworks. In these areas, equivalence is present but appears in a more fragmented or ancillary form. Here the relevant concerns shift towards investor protection and conduct supervision. Read together, Chapters 3 and 4 confirm the claim first advanced in Chapter 2 that the equivalence regime varies across sectors in its degree of openness, institutional design, functional orientation, and regulatory emphasis according to the logic of the sector concerned. Therefore, chapters 2-4 complete the internal dimension of the thesis by showing how the regime's general structure is realised in differentiated ways across the financial acquis.

The thesis then moves to the external dimension of equivalence. Chapter 5 addresses that question at the level of general external logic. It argues that the Union's external equivalence practice is shaped by two underlying policy drivers: financial stability and regulatory power projection. The first concerns prudential dependence, systemic risk, and the management of cross-border exposure. The second concerns the preservation of regulatory autonomy, the management of competition with other financial centres, and the projection of EU regulatory influence beyond the Union's borders. Chapter 5 further argues

that these drivers do not operate in isolation or in pure form. Rather, they combine in different proportions across different jurisdictional contexts. On that basis, the chapter develops three recurrent models through which the external operation of equivalence can be understood: an integrationist model, a defensive model, and a negotiationist model. This chapter therefore provides the general framework for analysing the Union's external use of equivalence.

Chapter 6 is closely connected to Chapter 5 and should be read as an extreme case. China is examined because it is a relatively closed market and it brings into view a more distinctive and complex form of external application. This chapter argues that when the Union engages with a relatively closed capital market such as mainland China, external regulatory connection is not always pursued in a direct and uniform manner. Instead, the Union adopts differentiated strategies depending on the systemic importance and market character of the relevant financial sector. In tightly coupled areas, especially those involving critical financial infrastructures, the Union is more likely to seek direct forms of connection with the target jurisdiction. In more market-oriented sectors, by contrast, connectivity may be mediated through Hong Kong as a brokerage city. The chapter therefore analyses Hong Kong not primarily from the perspective of mainland China, but from the perspective of EU external governance. It shows how Hong Kong can function as a jurisdictional intermediary through which the European Union projects regulatory preferences in a differentiated and strategically selective manner.

Methodology and Research Design

In this thesis a law-in-context approach was adopted that combines doctrinal legal analysis with comparative case studies and insights from political economy and global governance theory. The objective was not only to examine the legal provisions of the EU equivalence regime, but also to situate them within the broader institutional and political context that shapes their design, implementation, and global significance.

At the doctrinal level, a systematic analysis of the legislative frameworks in which equivalence has been embedded was adopted, which included the European Market Infrastructure Regulation, Markets in MiFID II/MiFIR, the Credit Rating Agencies Regulation, Solvency II, the Alternative Investment Fund Managers

Directive/Undertakings for Collective Investment in Transferable Securities framework, and the Prospectus and Transparency rules. Particular attention is paid to the legal foundations of equivalence, the allocation of competences between the European Commission and ESMA, and the specific mechanisms through which equivalence operates in different sectors. This doctrinal inquiry is complemented by an examination of implementing acts, ESMA's technical advice and the Commission's equivalence decisions.

In the present thesis a comparative case study method was employed. At the sectoral level, the development of equivalence across core domains (EMIR and MiFID II/MiFIR) and other financial sectors (i.e., issuer disclosure, funds, insurance and credit rating agencies) were compared to highlight divergent trajectories and outcomes. At the external level, case studies of the European Union's engagement with the major jurisdictions Switzerland, the United Kingdom and the United States, as well as with China and Hong Kong were conducted.

To capture the policy and governance dimensions, the research in this thesis draws on concepts from political economy and international relations. It examines the internal drivers of equivalence, including financial stability and the centralisation of supervisory authority at the EU level, alongside the external drivers shaped by regulatory power projection and the European Union's role in global standard-setting. At the global level, it employs theories of soft law and transgovernmental networks to explore how equivalence interacts with international bodies such as the G20, FSB, Basel Committee and IOSCO, assessing whether equivalence can be understood as a mechanism that supplements the weaknesses of international soft law.

CHAPTER 1: THE INTERNATIONAL REGULATORY CONTEXT OF EQUIVALENCE: SOFT LAW, EXTRATERRITORIALITY AND DEFERENCE

1.1 Introduction

This thesis begins from the premise that the EU equivalence regime cannot be properly understood in isolation, as if it were merely a technical mechanism for third country market access within EU financial law. Its significance becomes visible only when situated within the wider structure and evolution of international financial regulation itself. The equivalence regime emerged neither in a legal vacuum nor as a purely internal invention of the European Union. Rather, it belongs to a broader transformation in the governance of cross-border finance, one that has moved from pre-crisis reliance on soft-law coordination and technocratic standard-setting, through the post-crisis turn to financial stability and stronger assertions of extraterritorial control, towards more structured forms of conditional regulatory reliance. It is against this wider background that equivalence becomes analytically meaningful.

Accordingly, this chapter does more than provide contextual background. It lays the conceptual and historical foundations for the thesis as a whole. It first reconstructs the existing architecture of international financial regulation as a fragmented yet highly coordinated order, organised through transnational regulatory networks, sectoral standard setting bodies, and domestic implementation rather than through a unified treaty based legal system. It then examines the structural limits of that pre-crisis architecture, showing why a system capable of facilitating convergence in ordinary times proved inadequate once globally integrated financial markets collided with nationally bounded systems of supervision, political accountability, and crisis management. The chapter argues that the post crisis shift towards host control and extraterritorial regulation was a response to that failure, but also that this response generated a new difficulty of its own by intensifying regulatory conflict, duplicative compliance burdens, and market fragmentation.

Against that background, the chapter introduces deference as an intermediate governance model that emerged between two insufficient alternatives: broad soft law convergence on the one hand, and increasingly unilateral jurisdictional assertion on the other. Deference

made it possible to preserve the post crisis priority of financial stability while reducing the disruptive effects of overlapping regulation. Within this broader development, the EU equivalence regime is treated in this thesis as a paradigmatic form of deference. Within such a structured legal mechanism, reliance on foreign regulatory and supervisory frameworks is made conditional upon comparability, cooperation, and continuing oversight. This chapter therefore situates equivalence within the wider evolution of international financial governance and explains why it should be understood not simply as a market access tool, but as part of a larger reorganisation of cross border regulatory authority.

The chapter finally argues that the rise of deference was made possible by the pre existing technocratic infrastructure of international financial governance itself. Cross border reliance does not operate automatically. It depends upon shared evaluative languages, repeated supervisory interaction, and transnational epistemic communities through which foreign regimes become legible, comparable, and governable. Those conditions help explain why deference could become operational in practice, but they also reveal that such arrangements remain embedded in unequal structures of power, within which some jurisdictions are better positioned than others to define the relevant standards of adequacy and recognition. In this respect, the chapter provides the broader setting in which the central concern of this thesis can be pursued, i.e., how the EU equivalence regime has developed as a legally structured form of deference through which the Union manages external financial interdependence, safeguards its own regulatory and financial stability objectives, and exercises influence within the wider order of international financial governance.

1.2 The Existing Architecture of International Financial Regulation

Neoliberalism, technological advancement and financial innovation have jointly driven the expansion of cross-border capital flows.¹ At some point it was increasingly recognised that global challenges, at least to some extent, require global responses. Despite the fact that financial markets have become closely interconnected on a global scale through electronic information technologies and financial innovation instruments, there is no

¹ C. Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (2nd edn, Cambridge University Press 2015) 10.

binding international legal framework governing the de facto global financial market. Unlike other areas of international law, such as the law of the sea or the law of armed conflict, which rely on legally binding treaties and agreements, international financial regulation operates through a transnational regulatory network characterised by loose supervisory co-operation. This constitutes an informal mechanism of international coordination, wherein national governments and specialised domestic financial regulatory authorities convene to exchange views and, through forums and meetings, build consensus around the formulation and adoption of international principles and standards that lack binding legal force.

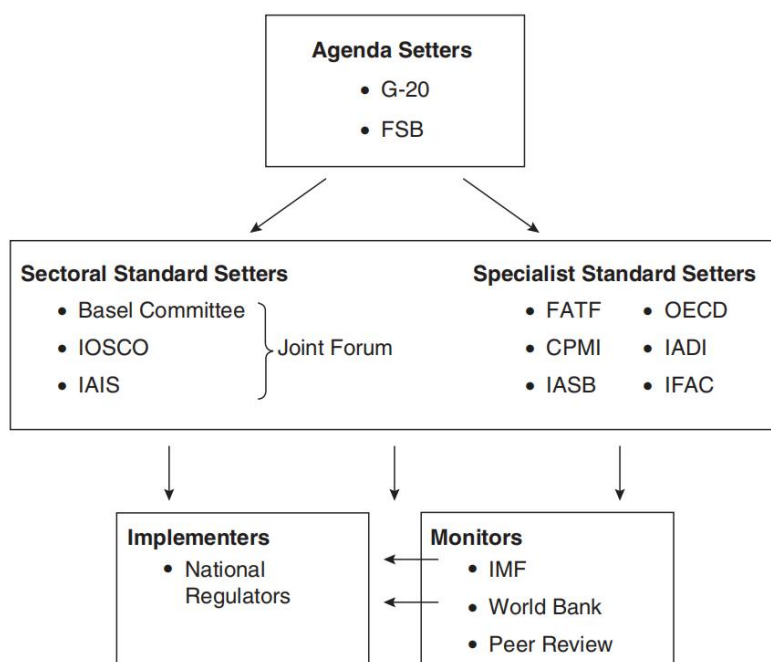
International financial regulation is not organised through a single treaty-based legal order. Unlike classic fields of public international law, it lacks both an overarching hard institution and a comprehensive body of binding multilateral conventions. Instead, global financial governance is structured through a fragmented but highly coordinated transnational architecture, within which governance responsibilities are carried largely by sector-specific regulatory bodies and non-binding standards rather than by formally enforceable treaty rules. In Bhattacharya's words, the collection of institutions consists of a 'tangled web'². In this sense, the operation of contemporary international financial regulation depends upon what may be called soft mechanisms: not merely soft rules, but the interaction between soft institutions and soft rules. The former refers to governance bodies that are themselves not constituted through comprehensive binding treaties and generally lack formal dispute settlement or coercive legal authority³; the latter refers to the standards, principles, recommendations, monitoring frameworks and review processes generated by those bodies, which do not possess direct binding force in international law and typically require domestic transplantation before they can acquire practical legal effect.

The contemporary architecture of international financial regulation is therefore best understood as a networked and layered order. According to Brummer's classification, the apex is occupied by political agenda-setters, principally the G20 and the FSB, which provide strategic direction, mobilise cross-jurisdictional political commitment and coordinate the broad trajectory of post-crisis regulatory reform. Beneath them sit the

² Arindam Bhattacharya, *A Tangled Web* (2009) 46(1) *Finance and Development* 40.

³ C. Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (2nd edn, Cambridge University Press 2015) 65.

specialised international standard-setting bodies, including the International Organization of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision (BCBS) and other sectoral organisations, which formulate technical standards for distinct areas of financial activity. At the lower level, domestic regulators, central banks and other national authorities undertake the work of implementation, supervision and enforcement within their own legal systems, while market participants internalise and react to these norms in practice⁴. In this sense, international financial regulation does not rest upon a centralised legal hierarchy, but upon a transnational regulatory pyramid in which political coordination, technical standard-setting and domestic implementation are functionally differentiated but institutionally interconnected.



Source: Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (2nd edn Cambridge University Press, 2015) 70.

Key: G20 = Group of Twenty, CPMI = Committee on Payments and Market Infrastructures, FATF = Financial Action Task Force, IADI = International Association of Deposit Insurers, IAKIS = International Association of Insurance Supervisors, IASB = International Accounting Standards Board, IFAC = International Federation of Accountants, IMF = International Monetary Fund, IOSCO = International Organization of

⁴ Ibid, ch 2.

Securities Commissions, OECB = Organisation for Economic Co-operation and Development

Figure 1.1: International Regulatory Organisation Architecture

Organisations closer to the apex of the pyramid perform increasingly abstract and politically driven functions, chiefly engaging in high-level policy coordination, issuing declaratory instruments and facilitating political consensus among states. In contrast, those at the base, such as International Organization of Securities Commissions (IOSCO) and national regulatory authorities, carry out concrete technical tasks, including rule-making, implementation and compliance supervision, relying heavily on the expertise of technical specialists and their institutional enforcement capacities. In contrast to the highly politicised nature of international agenda setters, these sectoral rule-making bodies include far fewer political figures as heads of state or finance ministers are typically excluded in them, and are instead dominated by specialised financial supervisory authorities possessing technical expertise⁵.

A central feature of this architecture is that many of its most important institutions are not hard international organisations in the orthodox sense. Even the G20 and the FSB, despite their considerable influence, are not treaty-based international organisations of the kind represented by the United Nations or the WTO⁶. Their authority instead derives from political coordination, institutional prestige and repeated participation by senior state actors, regulators and central banks. The choice to maintain a soft regulatory system in the context of the need for macro-financial regulatory coordination is not only due to the reliance on historical paths, but also to states' refusal to cede regulatory authority to a supranational agency.⁷ Although the 2008 global financial crisis has, to some extent, promoted the hardening reform of the international financial regulatory system⁸, in essence, the power of financial regulation is still concentrated in the hands of national authorities.

The same softness is reflected in the normative form of their outputs. International financial standards are generally produced as principles, guidelines, frameworks and recommendations rather than as binding treaty obligations. Their force therefore depends

⁵ David Held and Kevin Young, 'Global Governance in Crisis? Fragmentation, Risk and World Order' 50 *International Politics* 309, 2013.

⁶ David D Bradlow, 'The G20 and Africa: A Critical Assessment' (2014) 47(1) *George Washington International Law Review* 1, 9; Financial Stability Board, 'Articles of Association of the Financial Stability Board (FSB)' (11 June 2025) art 1 and art 10; Financial Stability Board, 'Charter of the Financial Stability Board' (June 2012) art 1.

⁷ M. Kahler and D. Lake, 'Economic Integration and Global Governance: Why So Little Supranationalism?' in W. Mattli and N. Woods (eds), *The Politics of Global Regulation* (Princeton University Press 2008) 242–276.

⁸ G20, 'Declaration on Strengthening the Financial System' (London Summit, 2 April 2009).

not on *pacta sunt servanda*, but on subsequent domestic uptake, administrative internalisation and ongoing supervisory alignment. The soft character of the institutions and the soft character of the rules are thus mutually reinforcing dimensions of the same governance structure.

The authority of soft mechanisms in international finance is partly sustained by what may be called technocratic or knowledge-based power. Standard-setting bodies such as IOSCO and the BCBS have acquired international standing not because they can legally compel compliance in the manner of a court or treaty organ, but because they are recognised as sites of specialised regulatory expertise⁹ and as coordinators of crisis response and supervisory practice. Their standards become focal points for convergence because they are produced within communities of experts whose technical judgments are treated as authoritative by both regulators and market actors. In a domain as complex and highly specialised as financial regulation, such epistemic authority is itself a significant source of norm-generating power¹⁰.

Moreover, ordinary membership of IOSCO consists primarily of national securities regulators and similar governmental authorities with significant supervisory authority in their own jurisdictions¹¹. This institutional composition gives IOSCO a specifically technocratic character: it is a peer club of regulators whose standards are formulated by those who are also capable of promoting their domestic adoption. Its influence therefore depends less on formal legal command than on regulatory embeddedness. The standards it develops can travel precisely because the actors who formulate them are also the actors best positioned to internalise them at home.

The IOSCO example illustrates this operating logic clearly. IOSCO does not rely on majority voting, but instead adopts a consensus-based approach that seeks broad agreement among members¹². This method reflects the sensitivity of soft-law governance

⁹ Annamaria Viterbo, 'The European Union in the Transnational Financial Regulatory Arena: The Case of the Basel Committee on Banking Supervision' (2019) 22(2) *Journal of International Economic Law* 205,208.

¹⁰ Yifeng Chen, 'Knowledge Power in Global Governance and Its Legal Regulation' *China Social Sciences Daily*, 14 September 2022, 4.

¹¹ International Organization of Securities Commissions, 'About IOSCO' (IOSCO) <https://www.iosco.org/v2/about/?subsection=about_iosco> accessed 27 March 2026; International Organization of Securities Commissions, *By-Laws*, s 1, art 6.

¹² Antonio Marcacci, *Transnational Securities Regulation: How it Works, Who Shapes It* (Routledge 2024) ch 4,117–148.

to sovereignty and regulatory diversity. Instead of attempting hierarchical imposition, it privileges coordination through acceptability and institutional cohesion. Although such a method may produce standards pitched at a level acceptable across different jurisdictions, it also enhances their portability and legitimacy within the network. This dynamic may also be understood in modest constructivist terms. The authority of such standards does not rest solely on formal legal bindingness, but is gradually reinforced through repeated interaction, mutual adjustment and the circulation of shared regulatory understandings within expert communities, because soft rules are more likely to be received and implemented when they emerge from repeated technocratic coordination and mutual accommodation rather than from overtly hierarchical imposition¹³.

IOSCO has also followed a characteristic two-step process in promoting implementation across jurisdictions. It first formulates non-binding standards, most prominently through the IOSCO Principles, and then relies on member authorities to incorporate those standards into domestic law and supervisory practice¹⁴. This process is supported by a range of incentives, including the enhancement of domestic regulatory capacity¹⁵, peer reputation pressures¹⁶ and institutional prestige¹⁷. Even in the absence of formal legal enforceability, these features help explain why international financial soft law has often exerted genuine practical influence.

That influence is reinforced further by recurrent review and by the embedding of soft standards within a wider international governance ecology that includes harder international institutions, particularly the International Monetary Fund (IMF) and the

¹³ Regarding constructivist theory, see eg. Alexander Wendt, *Social Theory of International Politics* (Cambridge: Cambridge University Press, 1999); Friedrich Kratochwil, *Rules, Norms, and Decisions: On the Conditions of Practical and Legal Reasoning in International Relations and Domestic Affairs* (Cambridge: Cambridge University Press, 1989); Kathryn Sikkink & Martha Finnemore, "The Justice Cascade: The Evolution and Impact of Foreign Human Rights Trials," *World Politics* 57, no. 1 (2005): 1–37.

¹⁴ Antonio Marcacci, *Transnational Securities Regulation: How it Works, Who Shapes It* (Routledge 2024) ch 4, 117–148.

¹⁵ See eg. International Organization of Securities Commissions, *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation* (May 2017) 22; International Organization of Securities Commissions, 'IOSCO members report high level of implementation for Principles relating to the Regulator' (15 February 2023).

¹⁶ M. DeBellis, 'The Legitimacy of Banking and Financial Standards: Representation, Due Process and Regulatory Capture' in M. Eliantonio and C. Cauffman (eds) *The Legitimacy of Standardisation As a Regulatory Technique: A Cross-Disciplinary and Multi-Level Analysis* (Edward Elgar 2020) 188–190.

¹⁷ C. Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (2nd edn. Cambridge University Press, Cambridge 2015) 120; Eleni Tsingou, 'Club Governance and the Making of Global Financial Rules' (2015) 22(2) *Review of International Political Economy* 225, 240.

World Bank. Bodies such as IOSCO may lack a formal judicial or treaty-based enforcement apparatus, but they have developed peer review structures and collaborative assessment practices that connect their standards to broader international oversight processes. In particular, IOSCO standards may be assessed through review arrangements undertaken in conjunction with institutions such as the IMF and the World Bank, including Financial Sector Assessment Program (FSAP) assessments and Reports on the Observance of Standards and Codes (ROSCs)¹⁸, which evaluate domestic compliance with internationally recognised regulatory IOSCO standards.

In certain crisis contexts, the IMF has gone further by making enhanced securities regulation and alignment with IOSCO standards a precondition for technical assistance or lending support. For instance, The IMF's 2016 technical assistance report on Ukraine explicitly recommended legislative amendments to align the domestic framework on market abuse and issuer disclosure with international standards and relevant EU legislation¹⁹. It also built on earlier IMF advice concerning the enhancement of the powers and independence of the National Securities and Stock Market Commission (NSSMC)²⁰. Crucially, this was not merely a standalone advisory exercise: the IMF later confirmed that the assistance had been delivered “within the framework of an IMF-supported program”²¹, while the contemporaneous Memorandum of Economic and Financial Policies (MEFP) under the Extended Fund Facility (EFF) incorporated corresponding commitments to align Ukrainian law with IOSCO Principles and to strengthen the powers, funding, and independence of the NSSMC²². This pattern is of long standing and the practice of linking financial assistance to domestic regulatory reform and convergence with international standards dates back to the 1997 Asian

¹⁸ The FSAP is a joint IMF–World Bank assessment exercise examining the stability of a jurisdiction's financial sector and the quality of its supervisory and regulatory arrangements; ROSCs are diagnostic reports assessing observance of internationally recognised standards and codes, including in financial regulation. Regards the interaction between IOSCO and them, see eg., Cally Jordan, *International Capital Markets: Law and Institutions* (2nd edn, OUP 2021) ch 3; IMF, 'Reports on the Observance of Standards and Codes (ROSCs)' <https://www.imf.org/en/publications/rosc> accessed 7 April 2026.

¹⁹ International Monetary Fund, *Ukraine: Technical Assistance Report—Regulation of Market Abuse and Issuer Disclosure Requirements* (IMF Country Report No 16/242, 2016)

²⁰ International Monetary Fund, *Ukraine: Technical Assistance Report—Enhancing the Powers and Independence of the National Securities and Stock Market Commission* (IMF Country Report No 15/284, 2015)

²¹ International Monetary Fund, Monetary and Capital Markets Department: *Technical Assistance Annual Report 2016* (3 October 2016) 18

²² International Monetary Fund, *Ukraine: Second Review Under the Extended Fund Facility and Requests for Waivers of Non-Observance of Performance Criteria, Rephasing of Access and Financing Assurances Review* (IMF Country Report No 16/319, 2016) annex, Memorandum of Economic and Financial Policies (MEFP) para 22

financial crisis. At that time, South Korea, in exchange for IMF support, committed itself to a series of structural reforms covering key areas such as financial supervision, market transparency and corporate governance²³.

In this way, non-binding standards are not left to operate in isolation. Rather, they are supported by forms of external evaluation, surveillance and, in some contexts, policy conditionality that increase the practical pressure for convergence. The result is not a transformation of soft law into hard law, but a hybrid structure in which soft rule-making is strengthened by harder channels of assessment and institutional reinforcement.

This interlocking structure helps explain why international financial regulation, despite lacking a unified treaty order, was long capable of producing meaningful convergence. Its effectiveness rested on the interaction of technocratic authority, club interests, reputational discipline and support from adjacent hard-law or hard-edged international institutions possessing greater supervisory leverage. The architecture worked not because it eliminated sovereignty, but because it organised cooperation in a form compatible with sovereignty.

Before the global financial crisis exposed its structural weaknesses, this architecture offered a workable form of governance for an integrated yet sovereignty-sensitive financial system. But when the demands of systemic crisis exceeded the coordinating capacity of the pre-existing international framework, the limits of this soft-law order has been revealed.

1.3 The Structural Limits of Pre-crisis International Financial Governance

As the previous section has shown, the pre-crisis international regulatory architecture was built primarily upon soft institutions, soft law and transnational regulatory co-operation. This framework provided a workable mechanism for co-ordination in an increasingly globalised financial system, but it did so without displacing the fundamentally national character of regulatory authority, supervision and crisis management, because financial sovereignty forms part of state sovereignty. In ordinary times, regulatory dialogue and non-binding standards could facilitate a degree of convergence. Yet the legal authority to

²³ International Monetary Fund, Korea: Letter of Intent (3 December 1997).

regulate domestic markets, the supervisory capacity to intervene in financial institutions, and the fiscal and political responsibility for crisis management remained anchored in national governments. For that reason, international co-ordination could supplement, but not replace, the state-centred foundations of financial governance. In this sense, the global financial market was de facto integrated, while the legal authority to regulate and stabilise it remained territorially fragmented. The global financial crisis brought this latent tension sharply to the surface. Although the strengths of such a soft governance network therefore lay in flexibility, technical exchange and consensus-building, its weakness lay in the absence of binding mechanisms capable of internalising cross-border externalities when national interests diverged.

The integration of international financial markets, combined with the regionally fragmented organisation of financial regulation, produced a deeper asymmetry within the international financial order, and this asymmetry was further reinforced by international financial law. On the one hand, market access and capital mobility were strongly protected through hard-law instruments, including trade and investment frameworks such as WTO General Agreement on Trade in Services (GATS), free trade agreements and international investment agreements. On the other hand, prudential regulation, financial supervision and financial stability were never subjected to an equivalent set of binding multilateral disciplines.

The legal architecture governing cross-border financial services was directed principally toward liberalisation. Under the GATS, the core disciplines focused on transparency, market access and national treatment²⁴, while the assumption of supervisory and stabilisation responsibility remained largely domestic. First, the GATS employs a positive-list approach²⁵, under which Members undertake market-access and national-treatment commitments only in those sectors and modes they specifically schedule, while retaining broad discretion elsewhere. Second, even where commitments are made, the Agreement expressly preserves domestic regulatory autonomy by recognising Members' right to regulate the supply of services in pursuit of national policy objectives²⁶. Third, and most importantly in the financial field, the Annex on Financial Services contains a

²⁴ World Trade Organization, *The General Agreement on Trade in Services: An Introduction* (WTO, September 2022) 3.

²⁵ World Trade Organization, *General Agreement on Trade in Services: An Introduction* 3, 10.

²⁶ *Ibid* 3.

broad prudential carve-out, allowing Members to adopt measures for prudential reasons, including for the protection of investors, depositors and policy holders, and to ensure the integrity and stability of the financial system, notwithstanding other GATS obligations²⁷.

The result was a system in which the law facilitated cross-border financial integration, while declining to impose an equally robust framework for the governance of the risks generated by that integration. Financial markets became globalised, but financial policy remained national. This mismatch between integrated markets and territorially bounded policy authority constituted one of the central institutional roots of financial nationalism and systemic instability.

The problem was aggravated by the persistence of domestic accountability structures. Even where financial activities, institutions and infrastructures operated across borders, regulatory authorities remained accountable primarily to domestic constituencies. They were expected to protect domestic financial stability, domestic taxpayers and domestic political interests, rather than the interests of foreign market participants exposed to spillovers generated by their own regulatory choices. Foreign victims of regulatory failure generally possessed neither political standing nor meaningful legal leverage within the jurisdictions whose rules affected them. Under such conditions, cross-border co-operation could only be expected where national interests happened to converge. As a result, the pre-crisis model of home-country control effectively enabled states to enjoy the benefits of international financial openness while externalising a significant share of the costs and risks to other jurisdictions²⁸.

Although the post-crisis period witnessed a certain hardening of the existing architecture of international financial co-operation, its underlying mode of governance did not fundamentally change. The establishment of the Financial Stability Board (FSB) as the successor to the Financial Stability Forum²⁹, together with the endorsement of its Charter by the G20 in 2009, strengthened the institutional framework of international co-ordination and gave greater prominence to financial stability as the organising priority of global regulatory reform. The post-crisis agenda likewise expanded the scope of

²⁷ Ibid,10

²⁸ Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (Cambridge University Press 2017) ch 3

²⁹ Group of Twenty, Leaders' Statement: The Pittsburgh Summit (24–25 September 2009) para 19.

international concern to all systemically important institutions, markets and instruments, reflecting a more assertive and stability-oriented form of co-ordination than had prevailed before the crisis³⁰. Yet these developments did not transform the basic character of the system. The FSB remained a body designed to co-ordinate national authorities and standard-setting institutions, not a supranational regulator endowed with autonomous law-making or supervisory powers. Regulatory authority remained firmly lodged within individual jurisdictions, while prudential preferences, market structures and political tolerances for risk continued to diverge. Under such conditions, comprehensive harmonisation was neither legally nor politically realistic; international financial governance could only proceed through forms of co-ordination that were soft, decentralised and mediated through national legal orders.

The persistence of this decentralised architecture suggests that the central issue is not whether soft law exists, nor how sophisticated its design may be, but rather when, and under what conditions, it is capable of securing meaningful compliance. In international financial governance, soft-law instruments did not operate with uniform effect across policy fields. Prudential instruments such as the Basel Accords and IOSCO principles are formally non-binding, yet they have often achieved comparatively strong compliance. By contrast, cross-border banking supervision and resolution illustrate the opposite dynamic. In crisis conditions, the relevant arrangements, including MoUs and home-host supervisory frameworks, are largely soft-law instruments, but they have frequently broken down³¹.

Mock compliance provides a particularly striking illustration of the decisive role of domestic political calculations in the implementation of international soft law. Even where states formally subscribe to common standards, they may resist meaningful implementation once those standards begin to constrain domestic firms, domestic credit conditions or domestic political priorities³². Maintaining the appearance of conformity is not difficult, particularly because soft-law networks often leave a degree of ambiguity in the formulation of standards in order to secure consensus and preserve flexibility at the

³⁰ See eg. G20, 'London Summit – Leaders' Statement' (2 April 2009) para 15; G20, 'Leaders' Statement: The Pittsburgh Summit' (25 September 2009); Financial Stability Board, 'Report on Implementation and Effects of the G20 Financial Regulatory Reforms' (9 November 2015) 1–2.

³¹ Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (Cambridge Univ. Press 2017) ch 8

³² *Ibid*, 226.

domestic level³³. As a result, while formal adherence may appear widespread, the actual implementation of those standards has been far from uniform, revealing significant divergence rather than genuine convergence across jurisdictions.

The literature on East Asia provides a clear illustration. Chey, through a political economy study of the adoption of the 1988 Basel Capital Accord (now known as Basel I) in Japan, Korea and Taiwan, found that while the Accord had been at the centre of international banking regulation for the past three decades and banks in East Asian countries have formally complied with it, their compliance had often been superficial due to widespread regulatory forbearance, which had weakened their actual capital soundness. Thus, domestic politics have ultimately determined countries' implementation of the Basel Accord³⁴. Walter reached the same conclusion in his study. It is the cost and benefit calculations of governments and firms, rather than international pressures, administrative capacity and ideological factors that determine compliance outcomes, especially in the short to medium term. In these countries, 'regulatory neoliberalism' convergence rarely occurs. On the contrary, in the countries he scrutinised, there was a huge gap between formal rules and substantial compliance with them. His findings illustrate that mock compliance can persist even when and where international pressure for substantial compliance is high³⁵. These studies are important not merely as examples of imperfect implementation, but as evidence of a more general proposition: so long as regulatory authority remains embedded in national political economies, international standards alone cannot guarantee meaningful co-ordination.

The derivatives sector provides an especially revealing example of this problem. Following the 2009 Pittsburgh commitment that standardised OTC derivatives should be centrally cleared, substantial progress³⁶ was indeed made toward the adoption of mandatory clearing obligations. Yet implementation remained highly uneven across jurisdictions. While many major economies introduced central clearing requirements,

³³ Rodrigo Coelho, Fernando Restoy and Raihan Zamil, *Convergence in the Prudential Regulation of Banks – What is Missing?* (FSI Insights on Policy Implementation No 24, Financial Stability Institute, February 2020).

³⁴ Hyoung-kyu Chey, *International Harmonization of Financial Regulation? The Politics of Global Diffusion of Policy Ideas* (Routledge 2014).

³⁵ Andrew Walter, *Governing Finance: East Asia's Adoption of International Standards* (Cornell University Press 2011).

³⁶ Group of Twenty, *Leaders' Statement: The Pittsburgh Summit* (Pittsburgh, 24–25 September 2009) para 13.

important differences persisted as to the products covered, the entities subject to clearing mandates, the thresholds applied, the use of incentive-based techniques and the extent to which local or cross-border clearing infrastructures were relied upon³⁷.

Such divergence reflected the discretionary room intentionally preserved within international technical standards, which allowed states to transpose global commitments into domestic law in materially different ways³⁸. This institutional elasticity created fertile conditions for both differentiated implementation and mock compliance. Even under a shared reform agenda, jurisdictions retained ample opportunity to delay, narrow or symbolically implement obligations in accordance with domestic preferences.

The global financial crisis made these limits impossible to ignore. The weakness did not lie simply in the absence of sufficient rules, but in a deeper mismatch between globally integrated financial markets and nationally bounded systems of regulation, supervision and political accountability. After 2008, financial stability became the dominant organising objective of global regulatory reform³⁹. The central question was no longer simply how to facilitate cross-border finance, but how to prevent cross-border financial integration from importing systemic risk into domestic and regional markets. Pre-crisis reliance on soft-law co-ordination and home-country control proved inadequate to manage cross-border externalities⁴⁰. The post-crisis shift toward stronger assertions of host control and extraterritorial regulation⁴¹ was therefore not accidental, but a response to the failure of the earlier model. Extraterritoriality thus became a means of internalising externally generated risks within the legal order of the market exposed to them. What emerged was a stronger insistence that access to the domestic or regional market should be conditioned upon compliance with the host jurisdiction's own regulatory expectations, especially where the activity or infrastructure in question was regarded as systemically

³⁷ Financial Stability Board, *OTC Derivatives Market Reforms: Eighth Progress Report on Implementation* (8 April 2014) 6.

³⁸ Financial Stability Board, *OTC Derivatives Market Reforms* (15 June 2012) 5.

³⁹ Group of Twenty, *Declaration on Strengthening the Financial System* (London, 2 April 2009) para 15; Group of Twenty, *Leaders' Statement: The Pittsburgh Summit* (24–25 September 2009) paras 7, 13; Financial Stability Board, *Improving Financial Regulation: Report of the Financial Stability Board to G20 Leaders* (25 September 2009) para 1.

⁴⁰ Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (Cambridge University Press 2017) ch 3, ch 4

⁴¹ See Katharina Pistor, 'Host's Dilemma: Rethinking EU Banking Regulation in Light of the Global Crisis' (2010) ECGI Working Paper No 286, 4–5; Eva Srejber, 'The Divorce between Macro Financial Stability Analysis and Micro Prudential Regulation and Supervision' (speech, 12 May 2005) 3; see also *Capital in Banking: The Neoliberalisation of the Global Banking System* (Cambridge University Press) ch 5.

significant.

A typical manifestation of extraterritoriality lies in the extension of substantive regulatory obligations to transactions conducted entirely outside the jurisdiction's territory. In the European Union, EMIR extends certain obligations, including the clearing obligation and risk-mitigation requirements for non-centrally cleared over-the-counter derivative contracts, to transactions concluded between two third-country entities in limited circumstances. Under EMIR, those obligations may apply where the relevant third-country entities would have been subject to them had they been established in the Union, and where the contract has a “direct, substantial and foreseeable effect” within the Union, or where the application of those requirements is necessary or appropriate to prevent the evasion of EMIR⁴². In this way, EMIR's extraterritorial reach does not operate solely through conditions on access to the EU market. It also permits the direct application of Union regulatory requirements to external transactions where the Union considers the connection to its regulatory and financial-stability interests sufficiently strong.

For present purposes, the significance of post-crisis extraterritoriality lies not only in its expansion of regulatory reach, but in its unintended systemic consequences. Measures adopted in the name of financial stability and regulatory control could also intensify jurisdictional rivalry, obstruct the development of coherent international solutions, and contribute to the fragmentation of globally integrated markets⁴³.

The OTC derivatives sector offers the clearest example. Because both the EU and the US had already entrenched extensive extraterritorial mechanisms as part of their post-crisis regulatory strategies, subsequent coordination became politically and institutionally difficult. As Posner and Quaglia show, the derivatives field was initially marked by failed unilateralism, with each side insisting on foreign compliance with its own regulatory template before eventually moving toward mutual accommodation through deference and exemptions⁴⁴. Similarly, Weinstein argues that the separate post-crisis regulatory paths adopted by the EU and the US contributed to market fragmentation and required a later,

⁴² 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, arts 4(1)(a)(v) and 11(12).

⁴³ Financial Stability Board, *OTC Derivatives Market Reforms: Fifth Progress Report on Implementation* (15 April 2013) 1; Financial Stability Board, *Report on Market Fragmentation* (4 June 2019) 1–3; IOSCO, *Market Fragmentation & Cross-border Regulation* (FR07/2019, June 2019) 3–6.

⁴⁴ Elliot Posner and Lucia Quaglia, 'Muscle Matters: An Integrationist Turn in Transatlantic Finance' (2025) *Perspectives on Politics* 1–23.

more negotiated effort at transatlantic accommodation⁴⁵. What emerged, therefore, was not a smooth path toward global convergence, but a drawn-out process of negotiated accommodation under conditions of continuing inter-jurisdictional tension.

Therefore, the post-crisis period exposed a new tension at the heart of contemporary international financial governance: the more states sought to secure stability through unilateral extensions of regulatory reach, the more they risked undermining the coherence of the cross-border markets they were simultaneously trying to stabilise. In this sense, the post-crisis shift to extraterritoriality solved one problem only by reproducing another. It reduced reliance on foreign supervision in areas deemed systemically significant, but did so at the cost of increased regulatory conflict and market fragmentation. Neither pre-crisis soft-law coordination nor post-crisis unilateralism could, by itself, provide a stable framework for governing integrated financial markets. The growing importance of deference mechanisms must be understood against this background. Deference, and especially equivalence, emerged as an intermediate governance technique designed to mitigate the disruptive effects of extraterritoriality while preserving the post-crisis priority of financial stability.

1.4 The Rise of Deference and Equivalence as an Intermediate Governance Model

Once major jurisdictions had embedded far-reaching domestic rules with cross-border effect into their own post-crisis stabilisation frameworks, a return to purely voluntary soft coordination was no longer realistic. At the same time, continued reliance on unilateral or overlapping assertions of jurisdiction threatened to entrench duplicative compliance burdens, regulatory conflict, legal uncertainty and market fragmentation, particularly in globally integrated sectors such as OTC derivatives.

It was against this background that deference rose to prominence as a new governance technique. As IOSCO observed, jurisdictions were engaging 'via recognition to solve regulatory overlaps, gaps, and inconsistencies'⁴⁶. Within this broader toolkit, national

⁴⁵ Stuart Weinstein, 'Transatlantic Extraterritoriality and the Regulation of Derivatives: The Need for an Integrated Approach between Washington and Brussels, the Uncertainties of Brexit and New Directions in the US' (2018) SWIFT Institute Working Paper No 2013-003.

⁴⁶ International Organization of Securities Commissions, Task Force on Cross-Border Regulation, Final Report (17 September 2015) 46.

treatment, recognition and passporting perform distinct functions in managing cross-border regulatory interaction⁴⁷. Under this classification, deference could be included as a form of recognition. As defined by the Financial Stability Board (FSB), deference refers to a situation in which a jurisdiction relies on another jurisdiction's regulatory and supervisory framework, provided that comparable regulatory outcomes are achieved. Such arrangements typically rest on conditional assessments, supervisory cooperation, and ongoing monitoring⁴⁸. In this sense, deference constitutes a mechanism built upon the overarching recognition of a third country's regulatory framework as functionally equivalent. Thus, although the post-crisis turn to robust domestic regulation cannot be reversed, deference sought to render that turn more manageable by a mutual recognition approach.

It is better to understand deference as a mechanism of conditional regulatory reliance rather than as a general gesture of trust or comity. Its core lies in the host regulator's conditional reliance on a foreign regulatory and supervisory framework while preserving its own regulatory objectives and control over market access⁴⁹. IOSCO's 2015 discussion of the United States substituted compliance makes this point particularly clearly that foreign requirements need not be identical, so long as they are capable of delivering substantively similar regulatory outcomes⁵⁰. In the EU context, the same logic is reflected in the Commission's account of equivalence. Where the foreign framework has legally binding requirements, ensures effective supervision, and achieves the same results as the corresponding EU rules, the host authority may rely on compliance with equivalent foreign rules⁵¹.

The first significance of deference lies in mitigating the conflicts generated by post-crisis extraterritorial regulation. The post-crisis regulatory shift did not simply strengthen prudential control; it also encouraged major jurisdictions to project their own rules

⁴⁷ Ibid 5–6, 7, 13, 31.

⁴⁸ Financial Stability Board, Report on Cross-Border Regulatory Issues (18 November 2014).

⁴⁹ International Organization of Securities Commissions, Market Fragmentation and Cross-Border Regulation (FR07/2019, June 2019) 5, 17; International Organization of Securities Commissions, Good Practices on Processes for Deference (FR06/2020, June 2020) 3.

⁵⁰ International Organization of Securities Commissions, Task Force on Cross-Border Regulation Final Report (June 2015) 29.

⁵¹ European Commission, 'Equivalence of non-EU Financial Frameworks' <https://finance.ec.europa.eu/eu-and-world/equivalence-non-eu-financial-frameworks_en> accessed 28 March 2026; European Commission, EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document SWD(2017) 102 final, 27 February 2017) 6.

outwards in order to shield domestic financial stability from foreign risks. Yet when multiple jurisdictions pursue this strategy simultaneously, the result is often duplicative compliance, overlapping claims of authority, legal uncertainty and the fragmentation of cross-border markets. By allowing one jurisdiction, under specified conditions, to rely on the regulatory and supervisory framework of another, deference softens the imposing effects of extraterritoriality.

The mechanism of deference is grounded in an assessment of regulatory comparability. Where such comparability is established, the host jurisdiction refrains from reapplying its full domestic rulebook to the same cross-border activity⁵², thereby avoiding the cumulative application of multiple regulatory regimes to a single institution, transaction, or market infrastructure. Instead, host authorities are able to rely on the home jurisdiction's regulatory and supervisory framework, subject to conditions of ongoing cooperation, information-sharing, and monitoring arrangements⁵³. By reducing duplicative compliance requirements and limiting the need for parallel regulatory application, the deference model also mitigates the market-fragmenting effects associated with post-crisis extraterritoriality and helps restore the loss of market efficiency caused by over-compliance⁵⁴.

Deference also helps to maintain international efforts to reduce regulatory arbitrage. Because it is premised on comparability assessments and sustained supervisory and cooperative arrangements, deference is ordinarily extended only where the jurisdictions concerned are considered capable of producing equivalent regulatory outcomes, though their detailed rules are not identical. At the same time, deference cannot eliminate regulatory conflict or arbitrage altogether. Even where it enables mutual reliance between jurisdictions, a number of structural differences that materially shape compliance costs and risk allocation may still persist. These include, in particular, differences in access to emergency funding and bailouts, the intensity of supervisory oversight, and the requirements relating to capital and collateral. So long as such divergences remain,

⁵² International Organization of Securities Commissions, *Market Fragmentation and Cross-Border Regulation* (FR07/2019, June 2019) 3, 5, 18–21, 34.

⁵³ Financial Stability Board, *OTC Derivatives Deference Processes: A Report on Bilateral Cross-Border Implementation Issues* (18 September 2014) 4; International Organization of Securities Commissions, *Good Practices on Processes for Deference* (FR06/2020, June 2020) 9–10.

⁵⁴ International Organization of Securities Commissions, *Market Fragmentation and Cross-Border Regulation* (FR07/2019, June 2019) 3, 13, 28; Financial Stability Board, *Report on Market Fragmentation* (4 June 2019) 8, 32–33, 37.

market participants will continue to have incentives to gravitate towards the jurisdiction offering the lowest-cost compliance environment, and the possibility of regulatory arbitrage cannot be fully removed⁵⁵. Deference nonetheless provides an important framework for managing these tensions. Rather than allowing conflict to take the form of direct collisions between competing rulebooks, it channels it into a more structured process centred on assessment, comparability, cooperation and, where necessary, withdrawal. This understanding is consistent with the European Commission's formulation of equivalence in its 2017 Staff Working Document, which presents it as a tool for managing cross-border activity within a sound and secure prudential environment rather than as a simple form of liberalisation⁵⁶.

Its second significance lies in addressing the principal institutional weakness of the soft-law order. Multilateral principles and supervisory dialogue could facilitate a degree of convergence at the level of standards, but they could not reliably govern those areas in which co-operation required one jurisdiction to bear concrete distributive or political costs for the benefit of others. Soft law is at its weakest precisely where questions of burden-sharing, emergency intervention, resolution, insolvency, fiscal support or crisis management arise⁵⁷, because these are the areas in which compliance is quite expensive. Once co-operation requires a regulator to expose domestic institutions, domestic public resources or domestic political capital to cross-border obligations, non-binding coordination becomes fragile. In such areas, the issue is not simply whether rules are formally aligned, but whether authorities have sufficient incentives to honour commitments when the domestic costs of doing so become acute. This is why, in high-distribution-cost fields such as rescue and resolution, soft law tends to fail: it cannot overcome the underlying political logic of financial nationalism⁵⁸.

Deference provides a way of attaching an institutional price to participation in integrated financial markets. Access to foreign markets is made conditional on assuming binding obligations of regulatory and policy co-operation. In this way, deference reconfigures

⁵⁵ Yesha Yadav and Dermot Turing, 'The Extraterritorial Regulation of Clearinghouses' (2016) 2(1) *Journal of Financial Regulation* 21, 26,49-50.

⁵⁶ European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment' SWD(2017) 102 final, 5.

⁵⁷ Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (Cambridge University Press 2017) ch 4

⁵⁸ *Ibid*, ch 8. See also the discussion of p 226 noted in Lorenzo Borlini, 'Book Review – The Logic of Financial Nationalism' (2019) *Global Policy*.

cross-border financial governance by linking the benefits of market integration to the burdens of sustained co-operation. Rather than allowing jurisdictions to claim the gains of openness while deflecting the costs of instability, it conditions market access upon the willingness and capacity of home authorities to participate in an enforceable framework of supervision, information-sharing, inspection, crisis management and even to adjust their domestic legal frameworks so as to maintain ongoing equivalence of regulatory outcomes.. In this model, co-operation ceases to be an aspirational soft-law preference and becomes part of the hard architecture of market access. Violation of co-operative duties may trigger suspension, withdrawal of access, or termination of the relevant rights, thereby ensuring that non-compliance produces a tangible institutional penalty.

In Lupo-Pasini's view, in the international financial governance setting, what matters is not abstract normativity but empowerment and retaliation capacity. Where foreign actors have no enforceable rights, and where non-compliance carries no meaningful consequence, co-operation will remain shallow. Compliance in international finance is not determined solely by the formal “strength” of a rule but depends more fundamentally on the attribution of rights and the capacity to attach consequences to defection⁵⁹. A regime will remain weak where affected foreign actors possess no meaningful institutional leverage and where non-cooperation does not alter the incentives of the jurisdiction concerned. By contrast, where access to a valuable market is made conditional, and where the host jurisdiction retains the capacity to suspend or revoke that access in response to a failure of cooperation, compliance becomes materially more likely. Deference is therefore significant not simply because it recognises foreign rules, but because it reallocates entitlements and consequences in a way that encourages states to internalise the external effects of their own regulatory choices. It shifts the logic of interaction away from one in which jurisdictions seek only the benefits of financial integration while externalising the costs of instability, and towards one in which the benefits of openness are institutionally linked to the burdens of ongoing commitment⁶⁰.

Against this background, the equivalence regime may be seen as the paradigmatic form of deference in contemporary financial governance: a mechanism through which market access is conditionalised, cooperation is institutionalised, and cross-border regulatory

⁵⁹ Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (Cambridge University Press 2017) 214–217

⁶⁰ *Ibid*, ch 9

conflict is managed without abandoning the post-crisis priority of financial stability.

The regime allows third-country firms and infrastructures to access the EU market where their home regulatory system is deemed to achieve outcomes equivalent to those required under EU law. Although the precise conditions vary across sectors, they are grouped under the broader institutional rubric of the equivalence regime, which creates a more systematic and umbrella-style framework for conditional recognition. Equivalence therefore operates not merely as a collection of isolated exemptions, but as an institutionalised logic of market access embedded across multiple areas of EU financial law. This is precisely what makes it analytically valuable for the present study. It shows how deference can be transformed from an ad hoc response to regulatory conflict into a structured legal architecture through which the Union manages cross-border regulatory interaction while preserving its own prudential and market-ordering objectives.

A brief comparison with the United States further clarifies the distinctive institutional character of the EU model. At a general level, both the EU equivalence regime and the US substituted compliance regime belong to the broader post-crisis turn towards deference because both mechanisms are recognition-based techniques designed to mitigate overlapping regulation, reduce duplicative compliance costs and render cross-border supervision more manageable.

The differences, however, are substantial. In the United States, substituted compliance has been developed above all in the field of derivatives regulation under the Commodity Futures Trading Commission (CFTC) and, to a lesser extent, the U.S. Securities and Exchange Commission (SEC). Although US substituted compliance also belongs to the broader family of deference-based mechanisms, it does not operate through the recognition of a foreign regulatory framework as a whole. Rather, it is primarily a rule-based technique under which particular US requirements may, subject to a comparability assessment, be satisfied through compliance with corresponding home-country rules. What is being displaced is therefore not the host regime as such, but specific host-state obligations in defined regulatory areas. In this sense, substituted compliance is better understood as a segmented and staggered approach to cross-border recognition: relief is granted incrementally, obligation by obligation, and often entity by entity, while the underlying US regulatory framework remains fully in place as the baseline reference

point.

By contrast, the EU equivalence regime is more clearly directed at the legal and supervisory framework of the third country itself. Although equivalence criteria differ across sectors, the mechanism is organised around a regime-level judgment that a third-country framework achieves sufficiently equivalent outcomes for the purposes of EU law. Once adopted, an equivalence decision forms part of a broader market-access architecture and is capable of producing effects beyond the individual applicant or transaction. The result is a more visibly institutionalised and regime-based form of deference, embedded within a broader cross-sector architecture of third-country market access. Therefore, the contrast shows not simply two variants of deference, but two different legal forms of deference. A controlled and rule-specific substitution technique on the US side while a more institutionalised and generalised mode of organised recognition on the EU side.

This contrast is especially clear in the derivatives clearing field. In the EU, clearing counterparty (CCP) equivalence has become one of the clearest and most developed examples of the equivalence technique, reflecting the systemic importance of central clearing infrastructure and the need to stabilise transnational market access through structured recognition (See detailed discussions in Chapter 3). In the United States, by contrast, the position of non-US derivatives clearing organization (DCO) illustrates a more fragmented and staggered toolkit.

For non-US DCOs, the CFTC distinguishes between exemption from registration and substituted compliance, even though both concern the cross-border application of derivatives rules. The former concerns registration obligation under the CFTC. Non-US clearing organisation may be exempted from DCO registration where it is subject to comparable, comprehensive supervision and regulation in its home jurisdiction and where satisfactory cooperative arrangements are in place with the home regulator⁶¹. Subsequently, where a non-US DCO is registered, the issue becomes whether it must comply in full with all US DCO requirements or may rely instead on compliance with the home-country regime to satisfy some of those obligations⁶². It is at this stage that substituted compliance performs its principal function. Under the CFTC framework, a

⁶¹ Commodity Futures Trading Commission, 'Exemption From Derivatives Clearing Organization Registration' (7 January 2021) 86 Fed Reg 949.

⁶² Commodity Exchange Act, 7 USC § 7a-1(c)(2)(A).

registered non-US DCO may satisfy the DCO Core Principles through compliance with applicable home-country legal requirements, provided that it is in good regulatory standing, does not pose a substantial risk to the U.S. financial system, and is subject to a satisfactory memorandum of understanding or similar arrangement between the CFTC and the home-country regulator⁶³. Even where such exemption of registration and substituted compliance are available, moreover, the DCO remains subject to continuing U.S. conditions relating to reporting, notice, inspection, and supervisory oversight⁶⁴. The U.S. model in this area is therefore not one of overarching framework-level recognition like the EU, but rather of staggered and sequential regulatory accommodation. Thus, That distinction reveals that the US system often proceeds through calibrated exemptions and regulatory adjustments within a framework still firmly controlled by domestic authorities, whereas the EU model more closely approximates an organised form of recognition of the foreign regime itself.

The rise of deference therefore marks an important reconfiguration in the architecture of international financial governance. It reflects the exhaustion of two insufficient models that the pre-crisis reliance on broad multilateral soft-law convergence, and the post-crisis temptation to manage cross-border finance through increasingly unilateral extensions of domestic authority. Deference occupies the space between them. It does not abandon the post-crisis priority of financial stability, but neither does it accept that stability can be preserved only through unmediated jurisdictional assertion. Instead, it offers a more conditional and managerial form of co-ordination, one in which regulatory autonomy is preserved, but exercised through institutionalised mechanisms of comparability, co-operation and recognition. Within that broader development, equivalence stands out as one of the most mature expressions of deference, and it is for that reason that the EU equivalence regime deserves separate and sustained analysis.

1.5 International Technocratic Networks and the Foundations of Deference

Even if the previous section explains why deference emerged as a post-crisis response to

⁶³ Commodity Futures Trading Commission, 'Registration With Alternative Compliance for Non-U.S. Derivatives Clearing Organizations' (21 October 2020) 85 Fed Reg 67160.

⁶⁴ Ibid, and Commodity Futures Trading Commission, 'Exemption From Derivatives Clearing Organization Registration' (7 January 2021) 86 Fed Reg 949;

regulatory conflict, market fragmentation, and overlapped compliance burdens, why could such a model operate in practice at all? Deference is not self-executing. It requires one jurisdiction to evaluate, rely upon, and in some measure continue to monitor the regulatory and supervisory arrangements of another. This presupposes more than formal legal rules or political commitments. It depends upon an underlying infrastructure of communication, expertise, and institutionalised interaction through which regulators are able to interpret foreign regimes, compare regulatory outcomes, and develop a workable basis for cooperation. Therefore, deference became operational because it could be embedded within an already existing transnational technocratic environment that had long structured international financial governance.

In this sense, deference should not be understood merely as a legal technique for granting market access, nor simply as a pragmatic response to the limits of unilateral extraterritorial regulation. It is also a governance form that depends upon the prior existence of cross-border regulatory networks and epistemic communities. Epistemic communities are networks of professionals with recognised expertise, shared belief systems and common causal understandings within a specific policy domain. They possess authoritative knowledge that enables them to influence political decision-making through the provision of policy advice, the construction of interpretative frameworks, and the development of regulatory standards⁶⁵. Technocratic institutions rarely operate in isolation; rather, they rely on transnational epistemic networks composed of epistemic communities.

International financial governance has long displayed these technocratic characteristics. As Baker notes, despite the presence of high-level multilateral forums such as the IMF and the G20, the vast majority of financial governance institutions internationally remain 'transnational' in character because they do not reflect a co-operative effort among heads of states, but co-operative efforts among executive agencies such as national finance ministries, central banking authorities and national financial regulatory authorities⁶⁶. They formed a more densely connected technocratic order in which expertise, supervisory practice, shared vocabularies of risk, and repeated institutional contact played a central

⁶⁵ P M Haas, 'Introduction: Epistemic Communities and International Policy Coordination' (1992) 46 *International Organization* 1 1–35.

⁶⁶ A. Baker, 'Deliberative Equality and the Transgovernmental Politics of the Global Financial (2009) 15 *Architecture. Global Governance* 2 195–218.

role. Consequently, the formulation of international regulatory standards has shifted from the realm of overt political negotiation to the domain of technical expertise, becoming the responsibility of 'a transnational policy community of experts actors'⁶⁷ who share common professional and educational backgrounds⁶⁸ and hold similar epistemological perspectives.⁶⁹ Deference could thus emerge not because states suddenly became willing to trust one another in an abstract sense, but because the governance network within which regulators operated had already generated the minimum conditions of mutual legibility, comparability, and conditional reliance.

The role of IOSCO is especially significant in this regard. Its importance lies not only in the production of principles, recommendations, and policy reports, but also in its function as a discursive arena within which securities regulators engage in ongoing professional interaction. Ordinary Members of IOSCO are national securities regulators whose legitimacy is rooted in technical competence and professional authority. This networked collaboration among technocrats transforms IOSCO into more than a platform for international financial rule-making and also functions as a transnational regulatory epistemic network, a global forum for the production, diffusion and coordination of regulatory knowledge⁷⁰.

Through committees, consultations, multilateral dialogue, and policy coordination, the IOSCO facilitates a form of regulatory socialisation: participants do not necessarily converge on identical rules, but they increasingly learn to speak in a shared professional language. It allows regulators to describe domestic regimes in terms intelligible to their foreign counterparts and to assess other jurisdictions not as wholly alien legal orders, but as systems that can be interpreted through a partially common vocabulary of supervision, enforcement, transparency, resilience, and market conduct⁷¹.

⁶⁷ E. Tsingou, 'Transnational Private Governance and the Basel Process: Banking Regulation, Private Interests and Basel II' in J.C. Graz and A. Nölke (eds), *Transnational Private Governance and Its Limits* (Routledge 2008).

⁶⁸ J. Chwieroth, 'Capital Ideas: The IMF and the Rise of Financial Liberalization' (Princeton University Press 2009); J.M. Chwieroth, 'Professional Ties That Bind: How Normative Orientations Shape IMF Conditionality' (2015) 22 *Review of International Political Economy* 4 757–787.

⁶⁹ E.B. Kapstein, 'Between Power and Purpose: Central Bankers and the Politics of Regulatory Convergence' (1992) 46 *International Organization* 1 265–287.

⁷⁰ Antonio Marcacci, *Transnational Securities Regulation: How it Works, Who Shapes it* (Springer 2023) chs 2–4

⁷¹ *Ibid*, ch 4

This technocratic setting is reinforced by capacity-building and ongoing forms of institutional contact. Broadly speaking, IOSCO's capacity-building activities fall into two main categories: educational and training programmes, and technical assistance programmes.⁷² The former aims to provide members with broad-based institutional knowledge and in-depth regulatory expertise, and the latter delivers on-site supervisory support, helping members address concrete difficulties encountered in implementing IOSCO Principles, the MoU and other IOSCO standards.⁷³

Repeated forms of interaction help reduce the practical distance between regulators, even where significant legal or structural differences remain. This does not eliminate divergence. As Brummer puts it: 'because technical assistance provides grounding in the basic principles and approaches employed by the assisting agency, it helps to reduce gaps in regulatory philosophy, understanding and possibly adjustment costs'.⁷⁴ Nor does it produce full harmonisation. But it does create the conditions under which deference becomes administratively plausible.

The first way in which such networks support deference is by generating common vocabularies and shared benchmarks of assessment. Deference requires some basis for judging whether foreign rules and supervisory practices are sufficiently robust, effective, or outcome-oriented to justify reliance⁷⁵. That judgment becomes possible only where regulators possess at least some common framework for evaluation. Technocratic networks provide such a framework by circulating concepts, standards, and evaluative criteria through which regimes can be compared⁷⁶. Terms such as effective supervision, comparable outcomes, risk mitigation, transparency, investor protection, or systemic resilience are not political but technical categories that structure how regulators perceive and assess one another. Through these categories, foreign legal regimes become legible. The crucial point is not that all jurisdictions must adopt identical rules, but that their rules can be translated into a common evaluative interpretation.

Secondly, technocratic networks reduce uncertainty through repeated interaction.

⁷² Ibid, 172.

⁷³ Ibid.

⁷⁴ C. Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (2nd edn. Cambridge University Press, Cambridge 2015) 53–54.

⁷⁵ Financial Stability Board, *Report on Market Fragmentation* (4 June 2019).

⁷⁶ See as IOSCO, *Objectives and Principles of Securities Regulation* (2017); Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* (April 2024).

Deference presupposes mutual reliance between jurisdictions, which ultimately rests on trust. Such trust is built less through abstract declarations than through repeated encounters in committees, supervisory dialogues, crisis coordination exercises, bilateral meetings, and other forms of institutionalised interaction within transnational regulatory networks. Over time, these interactions produce familiarity with the practices, competences, and constraints of foreign regulators⁷⁷. They make regulatory behaviour more predictable. In this sense, technocratic networks do not dissolve conflict, but they lower the informational and institutional barriers that would otherwise make deference too risky to sustain.

Rules are not passively discovered, nor are evaluative benchmarks given *ex ante*. Rather, they are constructed through ongoing interaction among regulatory actors. In this sense, technocratic governance networks demonstrate the functional relevance of a constructivist account of international regulation. Sustained, repeated interactions gradually give rise to expectations of normative consistency, thereby laying the social groundwork for equivalence determinations and mutual-recognition arrangements. When states anticipate that they will receive similar reciprocity from others in the future, they are more inclined to adhere to current standards, thus further reinforcing the consistency of those norms⁷⁸.

Thirdly, technocratic networks provide an important source of legitimacy for deference. Cross-border reliance on foreign regulatory arrangements is politically sensitive. Yet where such reliance is framed as a technical judgment based on regulatory outcomes, supervisory cooperation, and objective assessment, it acquires legitimacy from its technocratic character and thus becomes more politically defensible⁷⁹. Technocratic language helps recast what might otherwise look like a concession of sovereignty as a structured and conditional exercise in regulatory evaluation. In this respect, the discourse of equivalence, comparability, substituted compliance, or supervisory reliance performs an important legitimating function.

⁷⁷ See eg. Kenneth W Abbott, Céline Kauffmann and Jeong-Rim Lee, *The Contribution of Trans-Governmental Networks of Regulators to International Regulatory Co-operation* (OECD Regulatory Policy Working Papers No 10, OECD 2018) 37.

⁷⁸ Beth A Simmons, 'Compliance with International Agreements' (2005) 8 *Annual Review of Political Science* 195

⁷⁹ Michael Barnett and Martha Finnemore, *Rules for the World: International Organizations in Global Politics* (Cornell University Press 2004) chs 1–2 ; Reinout van der Veer and Gustav Meibauer, 'Technocracy, Populism, and the (De)Legitimation of International Organizations' (2024) 30(4) *European Journal of International Relations*, pp. 946–947.

At the same time, the technocratic infrastructure that enables deference should not be idealised. These networks are not politically neutral spaces in which all participants engage on equal terms. They are structured by significant asymmetries of market size, regulatory capacity, institutional resources, and agenda-setting power. International financial law has developed in a manner distinct from many other areas of international law because of its unusually technical character. As Waibel notes, its regulatory design has often been driven more by financial experts than by international lawyers, so that its early development was shaped less by familiar legislative techniques than by industry standards and self-regulatory practices gradually consolidated through market experience⁸⁰. Walter further argues that there are two primary sources of international financial standards. The first consists of standards issued by international standard-setting bodies. The second source lies in national standard-setting practices, particularly those of major Western powers, whose domestic rules and practices often closely align with the 'best practices' promoted by international organisations⁸¹. Thus, Great Powers and more established regulators are often better positioned to shape the terms of common standards, define the relevant benchmarks of assessment, and determine what counts as regulatory adequacy.

The language of shared expertise can therefore obscure the unequal distribution of influence within the network itself. Capacity-building may reduce divergence, but it may also operate as a channel through which dominant regulatory approaches are normalised and diffused. Likewise, the apparent neutrality of technical assessment may conceal deeper struggles over whose model of supervision, market structure, or risk management becomes the reference point against which others are judged.

This qualification is important because it clarifies the dual character of deference. On the one hand, deference depends upon technocratic coordination, shared knowledge, and institutionalised cooperation. On the other hand, it operates within a hierarchical international environment in which some jurisdictions possess greater authority to define the standards of comparability than others. Deference is thus neither pure mutual recognition nor pure hierarchy. It is a mediated form of cross-border governance, made

⁸⁰ Michael Waibel, 'Interpretive Communities in International Law', in Andrea Bianchi, Daniel Peat and Matthew Windsor (eds) *Interpretation in International Law* (Oxford, 2015; online edn, Oxford Academic, 23 April 2015).

⁸¹ Andrew Walter, *Governing Finance: East Asia's Adoption of International Standards* (Cornell University Press 2008) 6

possible by technocratic infrastructures but shaped by uneven power relations within those very infrastructures. This is precisely why it became such an attractive post-crisis governance tool. It offered a means of managing regulatory interdependence without requiring full harmonisation, while still allowing powerful jurisdictions to retain significant control over the terms on which foreign access would be recognised. As will be discussed in Chapter 5, the equivalence regime, as a paradigmatic form of the deference model, demonstrates how the European Union deploys it not merely to manage cross-border financial risks and safeguard financial stability within its jurisdiction, but also to project its regulatory influence externally, while simultaneously managing regulatory competition and preserving its regulatory autonomy.

In the following chapter, this thesis turns to an overview of the EU equivalence regime, examining how it operates procedurally, how financial stability is embedded in its institutional design, the centralising effects it produces within the EU legal order, and the pivotal role played by the European Securities and Markets Authority (ESMA) as a technocratic authority. Through equivalence, the Union translated broader patterns of transnational technocratic coordination into a more formalised and legally structured framework for governing third-country access. ESMA functions as the key actor through which such technocratic coordination is operationalised, centralised, and transformed within the EU's equivalence architecture.

CHAPTER 2: THE EUROPEAN UNION EQUIVALENCE REGIME: STRUCTURE, LOGIC AND INSTITUTIONAL OPERATION

2.1 Introduction

Having outlined in Chapter 1 the broader international context within which post-crisis financial regulation has developed, the analysis now turns to the central institutional mechanism examined in this thesis, namely the EU equivalence regime. Before providing a sector-by-sector doctrinal analysis, this chapter establishes the conceptual and institutional framework necessary for the later chapters by explaining what the equivalence regime is, how it operates, what policy logic increasingly structures it, and through which institutional actors that logic is implemented.

The chapter advances three connected arguments. First, the EU equivalence regime should not be understood as a unitary or generalised mechanism of third-country market access. Rather, it is a fragmented, sector-specific and risk-sensitive framework of selective managed reliance. The regime is outcome-based rather than dependent on identical legal rules. What matters is not formal legal sameness, but whether the third-country framework is considered capable of delivering sufficiently comparable regulatory and supervisory outcomes for the relevant EU purpose. At the same time, equivalence operates as a risk-management mechanism, in that the degree of access or reliance granted depends on the risks that the EU considers the relevant third-country framework and the cross-border activity in question to present.

Secondly, although equivalence is formally expressed through the language of outcomes-based comparison, its development and operation have become increasingly shaped by the rise of financial stability as a dominant organising principle of post-crisis EU financial regulation. Financial stability does not merely inform isolated equivalence decisions; it increasingly structures the scope of the regime, the intensity of scrutiny applied across sectors, and the growing reliance on ongoing monitoring and conditionality.

Thirdly, the equivalence regime has an important institutional dimension. By relocating key decisions concerning third-country reliance and market access to the Union level, it has contributed to the centralisation of financial governance within the EU. In this process,

ESMA has emerged as a key technocratic actor, not only in operationalising this centralising tendency internally through registration, technical assessment, monitoring and supervisory co-ordination, but also externally through bilateral engagement with third-country regulators and active participation in multilateral regulatory networks. Through these external functions, ESMA helps sustain supervisory consensus across jurisdictions, promotes convergence around international standards, and provides a channel through which EU regulatory preferences may be projected outward.

On that basis, the chapter proceeds in four steps. Section 2.2 introduces the equivalence regime as a fragmented and risk-sensitive framework, and explains its assessment criteria, decision-making process and ongoing monitoring structure. It then shows how financial stability has increasingly come to shape the regime's deeper logic and concrete operation. Section 2.3 examines equivalence as an instrument of EU regulatory centralisation, demonstrating how standardised third-country access has progressively been drawn into Union-level control from Member States. Section 2.4 turns to ESMA and analyses the technocratic functions through which the regime is administered, both internally within the EU supervisory architecture and externally through bilateral and multilateral co-ordination. The conclusion then draws these strands together and clarifies how the analytical framework developed in this chapter prepares the ground for the sector-specific examination that follows in Chapters 3 and 4.

2.2 Introducing the EU Equivalence Regime: Selective Managed Reliance and Structural Fragmentation

Having outlined in Chapter 1 the broader international context within which post-crisis financial regulation has developed, the analysis now turns to the central subject of this thesis: the European Union's equivalence regime. Broadly speaking, the EU equivalence regime is a framework under which a third country may, if its regulatory and supervisory system is considered capable of achieving outcomes sufficiently comparable to those required under EU law, obtain recognition, limited market access, or relief from certain duplicative compliance obligations within the EU, thereby reducing the need for piecemeal bilateral negotiations with individual Member States.

The regime is outcome-based rather than dependent on identical legal rules, and it is also risk-sensitive, in that the degree of access or reliance granted depends on the risks that the EU considers the relevant third-country framework and cross-border activity to present. In functional terms, equivalence allows the EU to rely, to a defined extent, on the regulatory capacity of third countries instead of requiring full replication of EU rules. It can thus be understood as a form of deference model: a conditional and unilateral mechanism through which the EU defers to third-country regulation where comparable outcomes and an acceptable level of risk are considered to be present.

The equivalence regime should be distinguished from passporting right stipulated in the Treaty on the Functioning of the European Union (TFEU), 'The passport relies on two elements: (i) a set of prudential requirements harmonised under EU law; and (ii) mutual recognition of licenses.'⁸² Passporting rights are an internal market mechanism available within the European Union, and, in extended form, within the European Economic Area. They rest on a far stronger legal and constitutional Union foundation than equivalence. Equivalence, by contrast, does not rest on shared membership of the same legal order. It is instead a unilateral determination by the Union that a third-country framework may, for limited regulatory purposes, be treated as sufficiently comparable to the EU standard. In that sense, equivalence offers a conditional and derivative pathway for engagement with the Union market, one that remains fully dependent on EU legislative design and institutional discretion.

Absent passporting or equivalence, third-country firms generally face a more onerous route into the Union market. They may be required to establish fully authorised local subsidiaries within a Member State, submit to host-state authorisation requirements, or operate only within the confines of specific national regimes (see detailed analysis in chapter 3-4). Such pathways increase compliance costs, generate duplicative obligations, and expose firms to legal uncertainty created by overlapping regulatory demands. From this perspective, equivalence can appear to be a facilitative mechanism: it allows the Union, under certain conditions, to reduce duplicative burdens, to recognise foreign supervision, and to permit a degree of cross-border market access without requiring full relocation or wholesale submission to host-state rules.

⁸² A. Margerit, M. Magnus, B. Mesnard, 'Third-country Equivalence in EU Banking Legislation' (European Parliament 12 July 2017) Briefing, PE 587.369

As the European Securities and Markets Authority (hereinafter ESMA) working paper has demonstrated, the equivalence policy was designed to meet three main objectives: (1) reconciling the needs of EU market financial stability and investor protection while maintaining an open and integrated internal market; (2) promoting international regulatory convergency; and (3) creating a 'major trigger' to popularise and enhance supervisory co-operation with other relevant jurisdictions⁸³. Yet it would be misleading to characterise equivalence simply as a market-access tool plus a international convergency-promoting mechanism, as equivalence is not synonymous with full market entry. It is better understood as a selective form of managed reliance: a mechanism through which the Union may decide, in specific sectors and under specific conditions, that external regulatory frameworks are sufficiently reliable for limited legal consequences within the EU order.

The feature above is first reflected in the regime's silo-based structure: equivalence does not operate as a general framework of third-country access, but arises only in discrete legislative contexts, each with its own scope, conditions and legal effects. In some contexts, equivalence functions as a gateway for access by third-country firms to parts of the internal market. In others, it does not provide market access at all, but instead produces more limited legal effects, such as prudential relief treatment (like in the Capital Requirements Regulation) or disclosure simplification(like in the Transparency Directive and the Statutory Audit Directive). The result is that “equivalence” in EU financial law is not a single legal institution with uniform content. It is a family of legislative techniques, all operating under the same label but performing different regulatory functions depending on the relevant sectoral context.

This fragmentation is reinforced by the broader sectoral, rather than activity-based, structure of EU financial legislation. Because “equivalence” is not a single legal institution with uniform content, but a series of sector-specific legislative techniques, its operation depends on the regulatory framework in which a given activity is located. The result is that functionally similar financial activities may receive different treatment for the purposes of third-country access. For example, the provision of loans or guarantees to professional clients may, where treated as part of investment services under MiFID/MiFIR, fall within a framework that provides for equivalence. Yet where lending is carried out by credit

⁸³ J. Deslandes, C. Dias and M. Magnus, 'Third Country Equivalence in EU Banking and Financial Regulation', (European Parliament August 2019) PE 614.495

institutions as part of traditional banking intermediation, it falls under the CRD framework, which does not provide an equivalent access route. In this sense, the sectoral structure of EU financial law amplifies the fragmented character of the equivalence regime⁸⁴.

The selective distribution of equivalence provisions indicates that the Union has not conceived equivalence as a universal model for opening the internal market to external actors. Instead, equivalence appears only where the legislature considers it normatively appropriate, institutionally manageable and compatible with broader regulatory objectives.

2.2.1 Equivalence: Assessment Criteria, Decision-Making and Ongoing Monitoring

In highly simplified terms, equivalence criteria may be described as requiring the Commission to verify whether a third country: (1) has legally binding requirements, (2) provides for effective supervision and enforcement by competent authorities, and (3) achieves regulatory results equivalent to those required under the corresponding EU framework⁸⁵. Through equivalence provisions embedded in sector-specific legislation, the European Union assesses whether the legal, supervisory and enforcement framework of a third country achieves outcomes that are sufficiently comparable to those pursued under the relevant EU legislation. The regime is therefore outcome-based rather than formally identical. However, equivalence is not determined by technical comparability alone. The Commission must also assess whether an equivalence decision would be consistent with broader EU policy priorities, such as international sanctions, anti-money laundering and counter-terrorist financing, tax good governance, and other relevant external policy considerations⁸⁶. Moreover, reciprocity is treated as an additional condition in some equivalence provisions that jurisdictions that have been granted EU equivalence are

⁸⁴ Ibid.

⁸⁵ European Commission, 'Equivalence of Non-EU Financial Frameworks' <https://finance.ec.europa.eu/eu-and-world/equivalence-non-eu-financial-frameworks_en>

⁸⁶ Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank State of Play of Preparations of Contingency Measures for the Withdrawal of the United Kingdom from the European Union, COM/2019/276 final, Document 52019DC0276, 12.6.2019

required to provide reciprocal or functionally comparable recognition of EU rules and entities to ensure mutual market access⁸⁷.

Although EU financial legislators have stipulated their assessment requirements in legal texts, the European Commission is empowered with discretion to make, and withdraw, an equivalence decision. The assessment process is based on technical advice from European supervisory agencies (i.e., EBA, ESMA or EIOPA), related international organisations or other stakeholder institutions. The third country involved would also enter into intensive dialogue within the process, although the Commission insists that the decision-making power is autonomous and the third country is not promised anything at the negotiation stage. When exercising the discretion, the Commission should take the objectives incorporated in the empowering legislation and the TFEU into consideration. The Commission would also take into account 'the promotion of common values and shared regulatory objectives at international level', as well as the interconnectedness between markets, the third country market size, the possibility of circumventing EU rules and so on⁸⁸. This means that equivalence is not a right vested in third countries once certain criteria are met. It remains a unilateral EU judgment shaped by strategic, prudential and institutional considerations.

As mentioned above, the equivalence regime is far removed from a unified set of rules. There are a variety of equivalence doctrines scattered in disparate financial services regulations and each of them is prone to follow its own logic from the legal Acts that govern it. While the internal heterogeneity of EU equivalence regimes is widely recognised, the Commission has nonetheless identified certain common principles across them. It has stated that 'under each specific equivalence type some common principles are respected: proportionality in the assessments, a risk-sensitive approach to determining equivalent outcomes, as well as enhanced transparency both towards the interested third country and the public at large.'⁸⁹

⁸⁷ European Commission, EU Equivalence Decisions in Financial Services Policy: An Assessment SWD(2017) 102 final, 27 February 2017, 6. Specific reciprocity requirement see like:Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1, art 25(6).

⁸⁸ European Commission, EU Equivalence Decisions in Financial Services Policy: An Assessment SWD(2017) 102 final(27 February 2017), 9.

⁸⁹ European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee, the

Foreign jurisdictions and markets under European Commission review for equivalence purposes display highly diverse structures, trading volumes, operating specificities, and usual patterns of supervision and enforcement. The risk exposure for the European Union varies significantly from case to case. The Commission would identify and consider those risks involved and apply the criteria in a way that is proportionate to the level of risks. For some 'high-impact' third countries, the Commission would negotiate in more detail to deal with the potential jeopardy in the EU financial system, while for some other 'low-impact' third countries, the assessment requirement would be lower proportionately. A typical 'high-impact' jurisdiction is the United States. Therefore, a decision to grant equivalence in the area of central counterparties for the US Commodities and Future Trading Commission regime includes special requirements in risk management measures on the calculation of initial margins, minimum liquidation periods and anti-procyclicality methods⁹⁰. This risk-based differentiation reveals that the equivalence regime does not simply ask whether a third-country framework is “the same as” or “different from” EU law, but it asks whether a third-country regime is sufficiently comparable in light of the risks associated with the particular market, infrastructure or activity in question. In other words, equivalence is calibrated by the risk profile of the relevant context and by the Union's tolerance for regulatory divergence in that context. Thus, it is better to see equivalence as a mechanism of selective and differentiated reliance, in which EU institutions remain free to tighten, narrow or condition that reliance in accordance with prudential judgment.

As regards transparency, although the equivalence regime is necessarily fragmented and calibrated to the specific risks addressed by different legislative acts, so that a fully uniform cross-sectoral framework is neither feasible nor desirable⁹¹, such legislative fragmentation nonetheless creates practical difficulties for third countries and market

Committee of the Regions and the European Investment Bank State of Play of Preparations of Contingency Measures for the Withdrawal of the United Kingdom from the European Union, COM/2019/276 final, Document 52019DC0276

⁹⁰ European Commission, Commission Implementing Decision (EU) 2016/377 of 15 March 2016 on the Equivalence of the Regulatory Framework of the United States of America for Central Counterparties That Are Authorised and Supervised by the Commodity Futures Trading Commission to the Requirements of Regulation (EU) No. 648/2012 of the European Parliament and of the Council, L 70/32

⁹¹ European Commission has stressed that 'it is now generally accepted that it would be extremely difficult to implement a uniform assessment and decision-making process encompassing various areas of equivalence', see European Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Equivalence in the Area of Financial Services, COM/2019/349 final, Document 52019DC0349

participants, who have increasingly called for greater transparency, consistency and predictability in both the assessment criteria and the decision-making process⁹². The EU's response has therefore not been to eliminate fragmentation, but rather to make the operation of the regime more transparent and manageable. The European Parliament has increasingly sought to render the assessment procedure more structured, granular, consistent and operational, while also clarifying the governing principles on which equivalence assessments are based⁹³. Additionally, the Commission seeks to provide third-country authorities with more extensive and standardised information at the outset of the assessment process, and expanded the public availability of information on its website and through regulatory dialogues, regional fora, conferences and joint statements⁹⁴.

Once the Commission has completed its assessment, it may formally adopt an equivalence decision by implementing act, subject to confirmation by Member State representatives through the relevant regulatory committee procedure. A positive decision signifies that the third-country framework meets the requirements laid down in the relevant EU legislation, although the decision may be granted in full or in part, for an indefinite or limited duration, and may include conditions or other limitations. Such decisions may apply to an entire regulatory framework, or only to particular entities, products, services, authorities, or regulated markets. The Commission also retains unilateral discretion to withdraw or change an existing equivalence decision where the relevant conditions so require, and there is no fixed deadline within which it must decide whether to grant equivalence⁹⁵.

Obtaining equivalence status recognition from the European Commission is not the end of the equivalence process. Both the European Union and third countries may modify and adjust their domestic regulatory frameworks in response to changes in the regulatory landscape. It is essential to determine whether the amended rules in the third country still achieve a substantially equivalent regulatory outcome compared with EU rules or, conversely, whether the unchanged rules in the third country still maintain substantial equivalence with the modified EU rules.

⁹² European Commission, *EU Equivalence Decisions in Financial Services Policy: An Assessment* (27 February 2017) Commission Staff Working Document (2017) 102 final, 12

⁹³ J. Deslandes, C. Dias and M. Magnus, 'Third Country Equivalence in EU Banking and Financial Regulation' (European Parliament August 2019) PE 614.495

⁹⁴ European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment' SWD (2017) 102 final, 10.

⁹⁵ European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment' SWD (2017) 102 final, 7–9.

This ongoing compliance of third countries granted equivalence status requires continuous monitoring by the ESMA. This monitoring involves more respectful and softer supervisory approaches, such as tracking changes in regulations within a third country and reviewing supervision records, and fostering collaboration between EU supervisors and their international counterparts. Strengthened supervisory collaboration with EU supervisors enable, for example, on-site inspections and efficient access to data in the third country. Moreover, monitoring should encompass not only legal requirements or supervision, but also pertinent market dynamics. For instance, if there is a substantial surge in the EU market exposure to an equivalent third country within the relevant sector, it would usually prompt the European Commission to conduct a fresh evaluation. The Commission has the authority to make adjustments, such as terminating equivalence, in response to any changes in jurisdictions where the rules and supervision were previously deemed equivalent to EU standards.

It is precisely here that deference mechanisms reveal their capacity to remedy some of the weaknesses of soft law. Equivalence is not a one-off or permanent status. Instead, it remains subject to ongoing monitoring, information exchange and the credible possibility of withdrawal, which discipline regulatory divergence and make continued cooperation institutionally meaningful. In this regard, third countries seeking the benefits of integration must therefore also assume the burdens of sustained supervisory engagement and policy responsiveness. A recent example is the United Arab Emirates. Following the European Commission's inclusion of the United Arab Emirates on its list of high-risk third countries with strategic deficiencies in their anti-money laundering (hereinafter AML) and counter-terrorism financing regimes on 16 March 2023, ESMA withdrew the recognition decisions for the following three central counterparties (hereinafter CCPs) established in the United Arab Emirates (including the Dubai International Financial Centre) because it contravened the AML obligations stipulated in EMIR for equivalent third countries⁹⁶. This demonstrates that the institutional price of participation is real: where a third country no longer sustains the conditions on which deference is premised, the legal and market benefits attached to equivalence may be removed.

⁹⁶ European Securities and Markets Authority (ESMA), 'Inclusion of the United Arab Emirates on AML Blacklist Requires ESMA to Withdraw the Recognition Decisions of Three CCPs' (ESMA 25 July 2023) <<https://www.esma.europa.eu/press-news/esma-news/inclusion-united-arab-emirates-aml-blacklist-requires-esma-withdraw>> accessed 23 March 2024

2.2.2 Financial Stability as the Dominant Organising Principle of Equivalence

As discussed in Chapter 1, the global financial crisis elevated financial stability from a secondary prudential concern into a central organising value of financial regulation. The same shift occurred within the EU. Although the EU equivalence regime is formally articulated through the language of outcomes-based comparison and regulatory comparability, its legislative design and practical operation cannot be understood solely on those technical terms. The deeper logic of the regime has been increasingly shaped by the rise of financial stability within the Union's post-crisis legal and regulatory order.

In the earlier stages of European integration, financial stability was originally a derivative concept subordinated to other primary objectives of EU law⁹⁷. The 2008 global crisis altered that position decisively. As instability spread across markets, banks, sovereign financing arrangements and the architecture of Economic and Monetary Union itself, financial stability was transformed from a prudential concern into a central justificatory value of European integration in the economic and financial sphere. In this context, the objective of financial stability was invoked to justify unprecedented supranational and intergovernmental compromises in key areas such as bank resolution, deposit insurance, financial assistance (both bail-outs and bail-ins) and fiscal policy coordination.⁹⁸ The importance of financial stability has progressively risen and culminated in the Pringle case⁹⁹, because it established financial stability as a 'higher' telos within the EMU. Subsequent judicial decisions reinforced that trajectory, consistently framing financial stability as an 'overriding public interest' capable of justifying exceptional interferences with fundamental rights and deviations from the principle of proportionality¹⁰⁰. The result was a reordering of the Union's normative hierarchy in financial regulation. Financial

⁹⁷ In the 1990s and early 2000s, financial stability was not part of the European Union's regulatory agenda but remained largely a matter of national discretion, pursued independently by individual EU Member States. The only explicit reference to the stability of the financial system in EU primary law could be found in Article 127(5) of the TFEU. This provision mandates the European Central Bank (ECB) to contribute to the smooth conduct of policies pursued by national competent authorities, insofar as such support does not conflict with the objectives of monetary policy. Accordingly, in the early stages of European integration, 'stability' in the euro area had to be understood in a more limited sense, situated within the context of the Economic and Monetary Union. Detailed demonstrations see Andreas Georgiou, *The 'Output' Legitimacy of Financial Stability in EU Law: Beyond Economic Functionalism* (PhD thesis, Durham University 2022) <<https://etheses.dur.ac.uk/14515/>>

⁹⁸ Augustin Jose Menendez, 'The Existential Crisis of the European Union' (2013) 14 *German Law Journal* 15 453, 454.

⁹⁹ Pringle (C-370/12) ECLI:EU:C:2012:756, paragraph 135. See Karlo Tuori and Klaus Tuori, *The Eurozone Crisis: A Constitutional Analysis* (Cambridge University Press 2014) 129.

¹⁰⁰ Kotnik (C-526/14) ECLI:EU:C:2016:570, paragraph 69; Ledra Advertising (C-8/15) ECLI:EU:C:2016:701, paragraphs 69 & 74.

stability ceased to be merely one prudential objective among many and became a cross-sectoral organising telos.

Brexit must be situated within this broader trajectory, and it plays an important role in such a shifting. The equivalence regime itself emerged after 2008 as part of a more deferential post-crisis governance paradigm. Its subsequent movement towards a more intrusive and controlling form cannot be explained by financial stability alone. Brexit mattered because it altered the internal political balance within EU financial governance.

EU Member States' distinct institutional structures have long supported different national models of financial capitalism, and these domestic differences have also been projected outward in the form of divergent external regulatory preferences. In the field of financial regulation, two coalitions have historically competed within the Union and sought to shape legislation in line with their respective preferences. On the one hand, the “market-shaping” coalition, represented above all by jurisdictions such as France and Italy, has been rooted in more bank-based financial systems and has generally favoured a more interventionist regulatory approach, with a stronger role for the state in the governance of finance. On the other hand, the “market-making” coalition, most notably associated with the United Kingdom¹⁰¹, has been linked to more capital market-oriented systems and has tended to prefer a more liberal and less interventionist approach. In the context of cross-border finance and relations with third countries, the market-making coalition favoured mutual recognition-type arrangements that would maximise cross-border financial integration with external jurisdictions. By contrast, the market-shaping coalition placed greater emphasis on regulatory control and financial stability, and was more inclined to subject foreign actors to EU standards¹⁰².

Brexit therefore removed from the Union a major advocate of market liberalisation, cross-border openness, and reliance on external markets. In doing so, it weakened the internal position of the market-making coalition and strengthened a more interventionist, market-shaping orientation within the EU. From the perspective of the market-shaping coalition, equivalence is better to be seen primarily as a mechanism for safeguarding Brussels'

¹⁰¹ Filippo Pennesi, *Equivalence in Financial Services: A Legal and Policy Analysis* (Springer 2022) 76.

¹⁰² David Howarth and Lucia Quaglia, 'Brexit and the Single European Financial Market' (2017) 55 *JCMS* 149, 150 – 153.

regulatory autonomy and protecting financial stability¹⁰³. Once the United Kingdom, as the Union's most important liberal financial market, ceased to act as a powerful internal counterweight, market-shaping Member States were in a much stronger position to reshape the EU's equivalence rules and procedures through legislative reform, thereby enhancing the Union's capacity to monitor and control risks originating from third countries.

That reordering of the Union's normative hierarchy in financial regulation had direct implications for equivalence. Conceptually, the regime had initially been framed in more deferential terms. It rested on the possibility that external jurisdictions, while institutionally different from the European Union, might nevertheless pursue sufficiently comparable regulatory objectives and outcomes to justify a degree of EU reliance¹⁰⁴. In this earlier vision, equivalence could serve several functions simultaneously: preserving the openness of the internal market, facilitating international regulatory convergence, reducing overlaps in compliance burdens, and encouraging co-operative relationships with foreign supervisors. It embodied a model of managed competitive diversity¹⁰⁵. Third-country regimes need not mirror EU law in form, so long as they produced equivalent effects in substance. In this sense, equivalence was compatible with a relatively generous understanding of regulatory comity.

Over time, however, the rise of financial stability narrowed the Union's tolerance for external divergence and hardened the regime. This evolution is reflected in the tightening of assessment criteria, the expansion of ongoing monitoring and the Commission's own description of equivalence as serving '..... primarily prudential regulatory purposes'¹⁰⁶ and constituting "primarily a risk management exercise"¹⁰⁷.

¹⁰³ See Lucia Quaglia, 'Brexit and EU Financial Regulation' in Patrick Diamond, Peter Nedergaard and Ben Rosamond (eds), *The Routledge Handbook of the Politics of Brexit* (Routledge, 2018).

¹⁰⁴ Lehmann, Matthias and Zetzsche, Dirk Andreas, 'How Does It Feel to Be a Third Country? The Consequences of Brexit for Financial Market Law' (April 15, 2018). CIGI & BIICL, *Brexit: The International Legal Implications* | Paper No. 14 <<https://ssrn.com/abstract=3155355>>

¹⁰⁵ Alexander Schaub, Testimony before the US House of Representatives, Director-General, DG Internal Market of the European Commission (May 2004) <<https://financialservices.house.gov/media/pdf/051304as.pdf>> Also see Tai-Bing Wei, 'The Equivalence Approach to Securities Regulation' (2007) 27 *Northwestern Journal of International Law and Business* 255.

¹⁰⁶ European Commission, *EU Equivalence Decisions in Financial Services Policy: An Assessment SWD (2017) 102 final*, 6.

¹⁰⁷ European Commission, *Equivalence in the Area of Financial Services COM(2019) 349 final*, 29 July 2019, 7.

Once that point is recognised, many of the regime's otherwise disparate features become easier to explain. Financial stability is gradually replacing market integration as its primary consideration, and it is not merely being “taken into account” within equivalence. It structures the terms on which equivalence is made available, the level of divergence the Union is prepared to tolerate, and the conditions under which third-country access can be maintained. In that sense, the regime has moved away from a trust-based model of deference and towards a more interventionist and defensive form of external governance. The selective coverage of equivalence provisions, the differentiated intensity of scrutiny across sectors, the lengthening of procedures in systemically important areas, the retention of broad Commission discretion, and the growth of ongoing supervisory monitoring all reflect a deeper value shift. These will be examined in the following section through an analysis of the relevant legislative texts and adopted equivalence decisions.

2.2.3 The Concrete Institutional Expression of Financial Stability in Equivalence Regime

The influence of financial stability appears in at least three closely connected dimensions of the regime: its selective legislative coverage, the differentiated intensity with which equivalence is applied across sectors, and the increasing reliance on mechanisms of continuing monitoring and control after recognition has formally been granted.

The first and most obvious expression of this logic lies in selective legislative coverage. The European Union may exclude equivalence provisions at the legislative stage as a means of applying differentiated regulatory treatment to high-risk financial activities. In the actual operation of the equivalence regime, the European Commission tends to prioritise the granting of equivalence to financial sectors that entail lower systemic risk or play a critical role in financial market connectivity. Conversely, in higher-risk areas, the European Union has explicitly excluded the applicability of equivalence clauses during the legislative design phase, effectively preventing third countries from obtaining formal recognition based solely on the merits of their domestic regulatory frameworks.

As already noted, equivalence does not appear across the EU financial acquis as a general route for third-country market access. According to the *acquis communautaire* of the

European Union¹⁰⁸, most of the core banking and retail financial activities are not subject to the equivalence regime¹⁰⁹ as they are closely associated with the protection of depositors and retail investors. Even within wholesale finance, equivalence is available only in limited and specifically defined areas¹¹⁰. The 2017 Securitisation Regulation did not include any equivalence mechanism. During its review in 2022, despite widespread market support for introducing an equivalence framework, the European Commission explicitly rejected the proposal. The rationale was that the European Union's securitisation rules were considered among the most advanced globally, making it unlikely that third countries could meet the same standards.¹¹¹ Moreover, the Markets in Crypto-Assets Regulation, formally adopted in 2023, also omitted any equivalence framework – further reflecting the European Union's highly defensive stance towards highly volatile and decentralised asset classes. Apart from the financial stability concerns, as Moloney observes, the deliberate exclusion of equivalence mechanisms in such cases also reflects the European Union's structural defensiveness towards the United Kingdom's dominant market position and marketing capacity in these sectors¹¹². Selective coverage therefore functions as an ex ante control mechanism: it sets the outer boundaries within which deference may be contemplated at all.

The second expression of financial stability within the regime lies in the differentiated intensity of scrutiny across sectors. Even where equivalence is legislatively available, it is not administered uniformly. Different sectors attract different levels of procedural depth, supervisory involvement and tolerance for divergence.

The International Swaps and Derivatives Association (hereinafter ISDA), in its report, recommends that regulatory authorities adopt a risk-based approach to achieve equivalence

¹⁰⁸ The *acquis communautaire* is the entire body of European Union (hereinafter EU) law and obligations accumulated by the European Union, including treaties, regulations, directives, court judgments and international agreements. Applicant countries must accept and incorporate the *acquis* into their national laws as a condition of EU membership.

¹⁰⁹ These areas cover (1) deposit-taking and lending activities under the Capital Requirements Directive, (2) payment services under the Payment Services Directive, and (3) retail investment services. See J. Deslandes, C. Dias and M. Magnus, *Third Country Equivalence in EU Banking and Financial Regulation*, (European Parliament August 2019) PE 614.495

¹¹⁰ For a detailed overview of the sectoral coverage of EU equivalence provisions and the current state of decision-making across the relevant legislative instruments, see Appendix A.

¹¹¹ European Commission, *Report From The Commission to the European Parliament and the Council Report on the Functioning of the Securitization Regulation (COM 2022 517)* <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52022DC0517>>

¹¹² Niamh Moloney, 'Third Countries and EU Financial Market Access: Technocracy, Politics, and the End of Deference?' in T Jaeger, M Lehmann, A Somek and M Waibel (eds), *Consolidating Brexit: The Future of EU/UK Cooperation* (Jan Sramek Verlag 2023) 203.

or substituted compliance¹¹³. In other words, when assessing comparability, regulatory authorities should primarily focus on risk-related rules, such as capital and margin requirements, clearing directives and regulatory reporting. Conversely, rules that do not involve risk, such as trading, public disclosure and business conduct, should be respected to the greatest extent possible. These considerations reflect local market characteristics and trading practices, thus ideally supervised by local regulatory authorities. In the CRD/CRR framework, equivalence does not primarily operate as a broad market-access mechanism. Rather, it functions mainly as a prudential recognition technique, allowing certain exposures of EU institutions to specified third-country entities or infrastructures to receive a more appropriate, and often more favourable, regulatory treatment for capital purposes. Precisely because the legal effects in this area are prudential rather than market-opening, the Commission has generally been willing to grant equivalence on a relatively broad basis, including in respect of credit institutions, investment firms, exchanges, central banks, and certain public sector entities. A similar logic can be seen in the field of accounting standards, where the Commission has recognised certain third-country Generally Accepted Accounting Principles (GAAP), most notably US GAAP and Japanese GAAP, as equivalent to EU-adopted International Financial Reporting Standards (IFRS) for the purposes of third-country issuers' financial reporting. By contrast, the Commission has been markedly more cautious where equivalence would affect access to core market activities or generate significant implications for financial stability and the competitiveness of EU financial markets, such as in relation to third-country investment firms or third-country trading venues for securities and derivatives¹¹⁴.

The Commission has long insisted that equivalence determinations must be proportionate to the risks posed by the relevant third-country market or actor. Thus, the Union reserves the right to intensify scrutiny wherever the potential consequences for financial stability are especially acute. In high-impact sectors, equivalence becomes slower, denser and more conditional. It is subjected to more searching comparison, to greater technocratic involvement and, often, to stronger post-recognition control. The treatment of US CCPs provides a clear example of this more demanding style of equivalence assessment, with the

¹¹³ International Swaps and Derivatives Association (ISDA), Chairman Eric Litvack's Remarks at ISDA Europe Conference, London, 26 September 2018. <<https://www.isda.org/2018/09/26/isda-chairman-eric-litvacks-remarks-at-isda-europe-conference-london/>>

¹¹⁴ For a detailed statistical overview and cross-sectoral comparison of equivalence decisions adopted by the European Commission, see Appendix A.

Commission taking several years to reach an equivalence determination under EMIR and differentiating between the regimes supervised by the CFTC and the SEC¹¹⁵.

Moreover, the existence of an equivalence clause in legislation does not guarantee its meaningful availability in practice; the Union can subsequently recalibrate the surrounding legal framework so as to make access through equivalence narrower, more conditional, and more tightly supervised.

One important technique is to amend the underlying legislative framework so as to introduce 'systemic importance' as a new classificatory threshold, thereby stratifying regulatory subjects into different tiers. This approach effectively raises the threshold for granting equivalence to third countries and narrows the scope of financial services that may access the EU market via this route. A notable example is the reinforcement of Markets in Financial Instruments Regulation (hereinafter MiFIR) obligations through the 2019 Investment Firms Regulation (hereinafter IFR) Reform. Under the revised framework, where the scale and scope of the services provided by third-country firms are likely to be of systemic importance for the Union, the Commission must carry out a more detailed and granular assessment of whether the third-country framework produces equivalent effects, while also taking supervisory convergence into account¹¹⁶. The reform further authorises the Commission to attach specific operational conditions to an equivalence decision¹¹⁷, and strengthens ESMA's registration, reporting, information-gathering and supervisory powers over third-country firms¹¹⁸. The result is that equivalence remains formally available, but its use is made more selective, more conditional, and more tightly tied to the Union's financial stability concerns.

¹¹⁵ Commission Implementing Decision (EU) 2016/377 of 15 March 2016 on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the Commodity Futures Trading Commission in accordance with Regulation (EU) No 648/2012 [2016] OJ L70/32; Commission Implementing Decision (EU) 2021/85 of 27 January 2021 on the equivalence to the requirements of Regulation (EU) No 648/2012 of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the U.S. Securities and Exchange Commission [2021] OJ L27/1.

¹¹⁶ 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 L173/84, art 47(1) second and third subparagraphs, and art 47(1a), as amended by Regulation (EU) 2019/2033 [2019] OJ L314/1, art 63.

¹¹⁷ Ibid

¹¹⁸ 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 L173/84, arts 46(2)(d), 46(4), 46(6a) – (6c), 47(1a), 47(2), 48 and 49, as amended by Regulation (EU) 2019/2033 [2019] OJ L314/1, art 63.

The other example is visible in the fund sector. As mentioned above, the equivalence regime excludes retail investment services from its effective reach, that is why the Undertakings for Collective Investment in Transferable Securities (hereinafter UCITS) framework, which is designed as a harmonised retail investment product regime centred on investor protection and product standardisation, contains no general equivalence mechanism for third-country funds or managers. By contrast, the Alternative Investment Fund Managers Directive (hereinafter AIFMD), which is primarily oriented towards alternative funds marketed to professional investors, does contain an embedded third-country framework and a possible passport extension for non-EU AIFMs and non-EU AIFs. Yet that regime has never been operationalised in practice. This contrast shows that even where third-country access mechanisms are written into the legislative text, their practical realisation remains contingent on Commission discretion and is shaped by the surrounding institutional environment, including the Union's assessment of investor protection, regulatory readiness and the degree of external dependence.

The third expression of financial stability within the equivalence regime lies in continuing supervisory control. As noted above, equivalence is no longer costless as it attaches continuing obligations to market access and requires third countries to sustain the conditions on which regulatory reliance is based. This is one of the key ways in which the deference model compensates for the limited enforceability of soft law. A framework of ongoing monitoring is therefore essential to the maintenance of that deferential relationship, because equivalence is not a one-off or permanent determination. In that sense, ongoing monitoring transforms equivalence from a static legal conclusion into a conditional supervisory arrangement. Equivalence is no longer treated as a one-off determination, but as a status that must remain continuously acceptable as legal frameworks evolve and market structures change.

To give effect to this design in institutional terms, the post-reform framework empowers the ESAs to monitor regulatory and supervisory developments, enforcement practices and other relevant market developments in third countries for which equivalence decisions have been adopted¹¹⁹, while the Commission has likewise framed equivalence as a risk-

¹¹⁹ Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010, and related legislation, [2019] OJ L 334/1.

management exercise that requires ex post monitoring, technical dialogue and, where necessary, review of existing decisions in light of material changes¹²⁰.

More recently, however, ongoing monitoring has also developed in a more on-shore and intrusive direction. Beyond the earlier model of equivalence monitoring, which was primarily based on ESMA's tracking of third-country regulatory and supervisory developments, together with information exchange and other forms of cooperative follow-up, the regime has increasingly incorporated direct supervisory tools more commonly associated with on-shore oversight. In particular, the growing use of on-site inspections has significantly strengthened the hard-edged character of the equivalence framework. In the MiFIR regime for third-country firms, the 2019 reforms introduced annual granular reporting obligations, powers for ESMA to request detailed information on transactions and orders, and powers to conduct investigations and on-site inspections; non-compliance with such requests or failure to cooperate may lead ESMA to restrict services or withdraw registration¹²¹. In the EMIR framework, ESMA's supervisory toolbox over systemically important third-country CCPs is even stronger. Tier 2 CCPs are subject to ongoing compliance review, and ESMA may carry out on-site inspections at their business premises, including outsourced entities, and in some circumstances without prior notice¹²². This development suggests that equivalence is no longer maintained solely through mutual confidence and regulatory dialogue, but increasingly through mechanisms that allow EU authorities to verify, investigate and intervene more directly where continued reliance is considered necessary.

¹²⁰ European Commission, 'Equivalence in the area of financial services' COM(2019) 349 final, 29 July 2019.

¹²¹ 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 L173/84, arts 46(2)(d), 46(4), 46(6a) – (6c), 47(1a), 47(2)(a), (c) and (d), 48 and 49, as amended by Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 [2019] OJ L314/1, art 63.

¹²² 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 L201/1, arts 25(2a), 25c and 25e – 25h, as amended by Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs [2019] OJ L322/1.

2.3 Equivalence as an Instrument of EU Regulatory Centralisation

Following the 2008 global financial crisis, a wide range of EU post-crisis financial services legislation incorporated third-country equivalence provisions¹²³. These provisions are notably more harmonised than their pre-crisis counterparts and have concentrated greater authority at the EU level¹²⁴ and the implementation of the Single Rulebook was also accelerated in such a context.

Once decisions concerning third-country reliance are made at Union level, and once those decisions are linked to ongoing supervision, monitoring and revocability, equivalence necessarily affects the internal distribution of regulatory power between EU institutions and Member State authorities. The EU equivalence regime should therefore be analysed not only in its external dimension, as a means of organising the Union's legal relationship with third-country regimes, but also in its internal dimension, as a mechanism of authority allocation within the European Union itself. Actually, equivalence has become one of the channels through which the Union has progressively centralised financial governance. It reallocates control over external market access upward, away from decentralised national gateways and toward supranational institutions that act in the name of the single market and financial stability.

In a decentralised model, Member States might retain substantial room to determine how, and on what terms, third-country firms and infrastructures may interact with domestic markets. Such an arrangement would permit a degree of regulatory pluralism within the Union itself, but it would also create incentives for divergence, forum shopping and uneven exposure to external risk. The equivalence regime works against that possibility. By vesting the formal power of equivalence determination in the Commission and by linking access in certain sectors to Union-level supervisory action, the regime reduces the capacity of Member States to act as independent gatekeepers. External access is no longer something to be negotiated or tolerated primarily at national level. It becomes part of a Union-wide regulatory strategy, defined by common criteria and supervised through

¹²³ European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment' SWD(2017) 102 final, 27 February 2017, 3, 12 and Annex 1.

¹²⁴ E Posner and L Quaglia, 'Financial Regulatory Conundrums in the North Atlantic' (2024) 63 European Journal of Political Research 682-704

common institutions. The external governance of third-country relations and the internal consolidation of supervisory authority thus proceed together.

This centralising tendency does not unfold with equal force across all sectors because the regime is silo-like, and the degree of institutional concentration varies significantly depending on the nature of the financial activity concerned. Nevertheless, certain sectors display the logic in especially clear form. The regulation of central counterparties (CCPs) and credit rating agencies (CRAs) offers the strongest examples. In both contexts, the Union has moved beyond a dual-track model (such as the entry of investment firms under MiFIR) in which Member States could individually manage the interface with third-country entities. Instead, it has created a single access architecture in which equivalence, recognition and ongoing supervision are all increasingly controlled at EU level. This increasingly harmonised framework complements the objectives of the CMU, as it reduces regulatory fragmentation across the European Union, and enhances both the efficiency and consistency of cross-border capital flows.

In the case of CCPs, the European Union has constructed one of the clearest examples of equivalence as a mechanism of regulatory centralisation. Third-country CCPs must pass through a standardised EU-level recognition process in order to provide clearing services within the single market, and are thereafter subject to direct oversight by ESMA. External access is thus removed from predominantly national control and reconstituted as part of a Union-wide supervisory framework.

This centralised structure is closely tied to the nature of CCPs themselves. Because CCPs concentrate counterparty risk, support multilateral netting, and connect participants across markets and jurisdictions, their regulation cannot easily accommodate divergent national approaches. Differences in prudential requirements, risk models or default management standards may undermine interoperability, disrupt liquidity, and generate systemic instability across borders. Given their systemic importance and the high concentration of the clearing market, fragmented supervision or parallel access models would generate unacceptable risks to financial stability.

A comparable example is found in the regulation of CRAs, where the European Union likewise established a centralised supervisory framework and used the equivalence regime

to control third-country market access. Under the Credit Rating Agencies Regulation (CRAR)¹²⁵, supervisory authority over the registration and ongoing oversight of CRAs was transferred to ESMA, marking one of the earliest instances of direct supranational supervision in EU financial regulation.

This centralisation was facilitated by the structure of the CRA market itself. The sector is highly concentrated and dominated by a small number of global agencies, most notably Moody's, Standard & Poor's and Fitch. In these circumstances, Member States had limited supervisory capacity and little scope to shape market conditions independently. The transfer of powers to the EU level therefore encountered relatively little resistance and was widely seen as a means of strengthening the Union's collective regulatory influence.

As in the CCP context, market access for third-country entities is no longer left to unilateral national decisions. Instead, non-EU CRAs must enter the single market through EU-level mechanisms, including equivalence-based arrangements and ESMA-led registration or certification procedures. The CRA regime thus illustrates how external access control and internal supervisory consolidation can be advanced simultaneously through a common regulatory framework.

Taken together, these examples show that equivalence is not simply a mode of deference to external regimes. It is also a vehicle through which the Union constitutes itself as the relevant supervisory centre for managing that deference. This internal effect is crucial. Equivalence allows the Union to transform questions of external recognition into questions of internal competence, institutional design and supervisory jurisdiction. Once third-country access is legally conditioned on Union-level determinations and Union-level follow-up action, supranational institutions inevitably acquire greater importance. In this way, equivalence becomes one of the practical sites at which the post-crisis shift toward more centralised, technocratic and stability-oriented financial governance is institutionalised.

This does not mean that centralisation is complete or uncontested. The Commission retains political discretion; the legislative frameworks remain sectorally differentiated; and the powers of supervisory authorities remain subject to judicially policed limits. Yet none of

¹²⁵ Regulation (EC) 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L302/1.

this negates the broader trend. The regime has created a concrete pathway through which external market governance and internal supervisory consolidation mutually reinforce one another. The more equivalence is used to manage systemic risk arising from third-country dependence, the stronger the case becomes for Union-level control over assessment, monitoring and enforcement. It is in that sense that equivalence should be understood as an instrument of EU regulatory centralisation.

That conclusion provides the bridge to the following part of this chapter. If equivalence has evolved into a regime of selective, stability-oriented and centrally administered reliance, then the role of ESMA within that regime can no longer be treated as merely ancillary. ESMA does not simply provide technical assistance to a Commission-led process. Increasingly, it operates as the institutional mechanism through which the Union produces, operationalises and monitors its conditions of external financial governance. The next part therefore turns to ESMA itself, and to the way in which its expanding functions within the equivalence regime exemplify the wider logic of technocratic governance in the post-crisis Union.

2.4 ESMA's Technocratic Functions within the Equivalence Regime

Following the overview of the equivalence regime in the previous section, the next step is to examine the institutional actor through which that regime is operationalised in practice. Although the formal legal power to adopt equivalence decisions lies with the European Commission, the day-to-day functioning of the regime depends to a considerable extent on the technical, supervisory and coordinative capacities of the ESMA. ESMA does not merely assist the regime from the margins. Rather, the equivalence framework has provided it with a concrete institutional arena in which its technocratic competences are translated into structured forms of regulatory authority. Through its role in registration, supervisory co-operation, technical advice and ongoing monitoring, ESMA has become a central actor in the practical administration of third-country access to the EU financial market.

This section examines ESMA's role within the equivalence regime through four core functions: first, the operation of EU-level registration and market-entry mechanisms; secondly, co-operation with third-country regulators through memorandums of

understanding; thirdly, the provision of technical advice to the European Commission; and fourthly, ongoing monitoring and soft rule-making. These functions should not, however, be treated as four isolated competences. Analytically, they reveal two connected dimensions of ESMA's position within the regime. Internally, they support the upward reallocation of supervisory authority from Member States to the Union level, thereby reinforcing centralisation within the EU's financial governance structure. Externally, they embed ESMA within bilateral and multilateral networks of technocratic co-ordination through which equivalence is assessed, maintained and, where necessary, recalibrated. The analysis below therefore proceeds in two steps: it first identifies the four functional channels through which ESMA operates within the regime, and then explains how those same functions generate both internal centralising effects and external co-ordination effects.

This internal-external distinction does not introduce a second, competing classification of ESMA's powers. Rather, it serves as an analytical lens through which the same set of functions may be understood. The question is not simply what ESMA does within the equivalence regime, but how these functions reshape the distribution of supervisory authority within the Union and structure regulatory engagement beyond it. Seen in this way, ESMA emerges not only as a technical agency implementing pre-existing rules, but as a network actor whose role in the equivalence framework connects internal supervisory consolidation with external technocratic governance.

2.4.1 The Four Core Functions of ESMA within the Equivalence Regime

(1) Operation of EU-Level Registration and Market Entry

The first function concerns ESMA's role in operating EU-level recognition and registration mechanisms for third-country entities. In several equivalence-based frameworks, access to the Union market is not mediated through dispersed national authorisation alone, but through centralised recognition procedures administered at EU level. Where equivalence decisions are linked to ESMA-maintained registers, entry into the EU market is effectively channelled through a Union-level gatekeeping structure. By providing a single-entry point, this centralised registration mechanism avoids fragmented national approval processes, which may otherwise lead Member States to impose implicit barriers or lower substantive supervisory standards in order to attract capital inflows. The role of national competent

authorities is thereby reduced to a minimum, preventing regulatory fragmentation and reinforcing the trend towards centralised market access and the consolidation of technical authority at the EU level.

Moreover, under this mechanism, ESMA is not only responsible for conducting the technical assessments of substantive equivalence, but also for performing the registration, ongoing supervision and information-gathering functions with respect to third country entities. This arrangement effectively grants ESMA a partial gatekeeping role at the EU level, even though the final decision-making power remains with the European Commission. As recommended in the De Larosière Report¹²⁶, the establishment of supranational regulatory bodies, namely ESMA, EBA and EIOPA, was deemed essential to address the regulatory fragmentation exposed by the global financial crisis. The report emphasised the need for a legally and institutionally coherent supervisory framework at the EU level. Schammo¹²⁷ further argues that the creation of ESMA represents a 'technocratic form of centralisation' but one that also signals a deeper shift in regulatory decision-making authority: from the national level to the European Union's political institutions.

In addition, ESMA leverages its position as a market regulator to introduce innovative supervisory mechanisms through soft rules in financial services sectors where the ESMA registration approach has not been established as the single point of entry into the EU Single Market. In the area of prospectuses, for instance, while formal approval of third-country prospectuses remains with national authorities, in 2011 ESMA established a “wrap” mechanism requiring supplementary information to align third-country prospectuses with EU disclosure standards¹²⁸. Applied in the case of Israel¹²⁹, this framework effectively gave ESMA a pre-screening role, since its opinions became an unavoidable reference point for NCAs. (See details in Chap 3)

¹²⁶ Jacques de Larosière (Chair), Report of the HighLevel Group on Financial Supervision in the EU (25 February 2009).

¹²⁷ Pierre Schammo, 'EU Day-to-Day Supervision or Intervention-based Supervision: Which Way Forward for the European System of Financial Supervision?' 38 *European Law Review* 5 (2013) 751–767.

¹²⁸ European Securities and Markets Authority, 'Statement on the Framework for Third Country Prospectuses under Article 20 of the Prospectus Directive' (23 March 2011) ESMA/2011/36; European Securities and Markets Authority, 'Opinion on the Framework for Third Country Prospectuses under Article 20 of the Prospectus Directive' (27 March 2013) ESMA/2013/317.

¹²⁹ ESMA, 'ESMA establishes a framework for third country prospectus and applies this new framework to facilitate Israeli issuers' Press Release ESMA/2011/82
<https://www.esma.europa.eu/sites/default/files/library/2015/11/11_82.pdf> accessed 23 March 2011.

ESMA's introduction of a 'wrapped' package for prospectus disclosure obligations represents a regulatory innovation that, in effect, shifts the locus of supervisory judgement upward to the EU level. Through this mechanism, ESMA exercises de facto pre-screening authority and informational control over the prospectus disclosure process: it determines which third country regimes require a wrap and specifies the additional information needed, thereby acquiring the power to make the initial judgment on whether disclosure obligations are adequately fulfilled.

This development also illustrates the centralising effects of soft law. Although ESMA has not acquired formal legal competence through binding legislation, its opinions have become de facto standard-setting tools that NCAs must follow in practice. The concentration of regulatory power through non-binding instruments thus reveals a distinctive form of informal, non-legislative centralisation within the EU supervisory architecture.

To the extent that these mechanisms standardise the conditions under which third-country entities may access the EU market, ESMA's entry-related functions do more than administer technical procedures. They contribute to the construction of a single EU baseline for third-country access and reduce the scope for supervisory divergence at national level. In this respect, registration is not simply an administrative step, but part of a broader process by which equivalence becomes a vehicle for centralised regulatory control.

(2) Obligations to Co-operate with Third Countries through Memorandums of Understanding

Within the European Union's equivalence framework, the conclusion of MoUs between ESMA and third country supervisory authorities constitutes a core mechanism for fulfilling cross-border supervisory coordination. These arrangements are not merely ancillary instruments of courtesy or information-sharing. They form part of the institutional infrastructure through which equivalence is made operational on a continuing cross-border basis. In legal terms, the conclusion of an MoU may constitute a condition for the recognition of third-country entities such as CCPs or CRAs¹³⁰. MoU typically include the

¹³⁰ See Article 25(7) of EMIR and Article 5 of the CRA Regulation

following four core components: a) regular supervisory information exchange¹³¹, b) notification of regulatory changes¹³², c) co-operation on on-site inspections¹³³, and d) assistance in cross-border enforcement¹³⁴.

Although MoUs are not legally binding instruments, in ESMA's supervisory practice they are treated as foundational conditions for maintaining equivalence status. A breach of MoU commitments may trigger a reassessment or suspension of the equivalence determination¹³⁵. Additionally, at the operational level, MoUs function as tools for extending regulatory reach beyond the European Union's legal jurisdiction, granting ESMA indirect supervisory capacity over third country market participants in a technical sense. Through such arrangements, ESMA is able to access risk-related information from non-EU financial market infrastructures, monitor their continued compliance with EU regulatory standards and, where necessary, issue warnings or recommend the withdrawal of equivalence status to the European Commission. MoUs are commonly used as non-binding frameworks for regulatory cooperation, creating structured channels for consultation, information exchange

¹³¹ See, for example, European Securities and Markets Authority, Memorandum of Understanding between the ESMA and the Bank of England concerning third country CCPs recognised under EMIR, Arts 3–6 (17 March 2025) ESMA91-2145765636-11152 <https://www.esma.europa.eu/sites/default/files/2025-03/ESMA91-2145765636-11152_ESMA-BoE_MoU_TC-CCPs_EMIR_3.pdf>.

¹³² See, for example, US Commodity Futures Trading Commission and European Securities and Markets Authority, 'Memorandum of Understanding Concerning Cooperation and the Exchange of Information Related to Certain Registered Derivatives Clearing Organizations' <https://www.cftc.gov/media/5581/CFTC_EMMA_MOU010621/download>

¹³³ See eg European Securities and Markets Authority and US Securities and Exchange Commission, 'Revised Memorandum of Understanding between ESMA and SEC Regarding Cooperation and the Exchange of Information on Third-Country Central Counterparties' (final version) <date unspecified> <https://www.esma.europa.eu/sites/default/files/library/revised_mou_esma-sec_us_tc-ccps_-_final.pdf>

¹³⁴ See eg. Article 25(7) of EMIR requires that co-operation arrangements include mechanisms for 'effective exchange of information and coordination of supervisory activities, including on-site inspections'. Additionally, in practice, these clauses are detailed in multiple MoUs. For instance, the 2016 ESMA–CFTC MoU states that '[u]pon request, the Authorities intend to assist each other in obtaining information from Covered Firms, including information that may be used in administrative or civil proceedings concerning possible violations of laws or regulations' and further provides that authorities 'may consult on taking coordinated enforcement actions when appropriate. Similarly, in the 2022 revised MoU between ESMA and the Hong Kong Securities and Futures Commission, it is stated that '[t]he Authorities intend to provide each other with the fullest possible mutual assistance in securing compliance with their respective laws and regulations', particularly in cases where CCPs may pose systemic risks or engage in misconduct.

¹³⁵ See eg ESMA, 'Memorandum of Understanding between ESMA and the Securities and Futures Commission of Hong Kong' (2022); ESMA, 'Memorandum of Understanding between ESMA and the Bank of England' (2025); and ESMA, 'Memorandum of Understanding between ESMA and the United States Commodity Futures Trading Commission' (2016).

Each provides, in substance, that if the MoU is terminated and not replaced within a reasonable period by an equivalent arrangement, ESMA may consider withdrawal of the recognition of the relevant CCPs pursuant to art 25 EMIR.

and supervisory coordination where no formal treaty framework governs the relationship¹³⁶. In an increasingly politicised environment of equivalence governance, such technical co-operation arrangements offer the European Union both regulatory resilience and a functional basis for external rule projection.

(3) Technical Advice to the European Commission

As a technical authority, ESMA is tasked with providing the European Commission with technical advice concerning equivalence assessments¹³⁷. Within the equivalence framework, positive technical advice from ESMA is often treated as a prerequisite for the Commission to consider granting an equivalence determination to a third country. This reliance on expert judgment reflects a technocratic mode of governance, whereby ESMA assumes a de facto pre-screening role in the equivalence process, shaping both the initiation and trajectory of the Commission's assessment. In general, the relationship between the Commission and ESMA is co-operative, this does not imply that the Commission will automatically adopt ESMA's recommendations. Tensions may still arise at the operational level between institutional authority and technical expertise, highlighting the underlying boundaries of power and professional discretion within the European Union's regulatory architecture.

The advisory function of ESMA is not limited to the assessment and ongoing monitoring of third country regulatory frameworks. In financial sectors not yet formally covered by equivalence provisions, ESMA may also be tasked by the European Commission with conducting forward-looking assessments. These evaluations serve as market-grounded preparatory work for potential future reforms of the legislative framework, thus assigning ESMA a pre-legislative technocratic function. The investment fund sector offers a prominent example of this type of activity. In 2015, ESMA delivered detailed advice on the potential extension of the third-country passport to several non-EU jurisdictions¹³⁸.

¹³⁶ U.S. Securities and Exchange Commission, 'SEC's Cooperative Arrangements with Foreign Regulators' (12 May 2017) https://www.sec.gov/about/offices/oia/oia_coopfactsheet accessed 7 April 2026.

¹³⁷ 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 L331/84, arts 8 and 10.

¹³⁸ European Securities and Markets Authority, ESMA Advises on Extension of AIFMD Passport to Non-EU Jurisdictions (final Report, 25 November 2015)

Although the regime has never been activated, this episode illustrates ESMA's pre-legislative technocratic role in preparing the ground for potential reforms. (See details in Chap 4).

(4) Ongoing Monitoring and Soft Rule-Making Influence

Because the equivalence framework includes a post-recognition monitoring process, ESMA's ongoing evaluations continue to shape the status and continuity of equivalence. Even after a positive equivalence decision has been granted, subsequent findings by ESMA indicating material divergence between the third country framework and EU law may lead to the unilateral withdrawal of equivalence. A typical case occurred in 2019, on the basis of ESMA's technical advice, the EU withdrew the equivalence decisions for Argentina, Australia, Brazil, Singapore, and Canada¹³⁹, as these jurisdictions had failed to amend their domestic legislation on credit rating agencies to align with the 2013 amendments¹⁴⁰ to the EU Credit Rating Agencies Regulation¹⁴¹. This development sent a clear signal to the market: in order to maintain equivalence, third countries must ensure continual alignment with the European Union not only in terms of regulatory objectives and domestic implementation, but also in the level of investor protection. Moreover, such alignment must be actively maintained through timely updates to domestic rules in response to changes in EU standards.

Moreover, this function of providing technical advice is closely intertwined with ESMA's broader normative role. In practice, technical advice goes far beyond submitting a binary assessment report on whether a third country regulatory framework is equivalent to EU rules in a specific domain. It encompasses a wide range of instruments, including draft Regulatory Technical Standards (RTSs), Implementing Technical Standards (ITSs) prepared under delegated authority from the Commission, interpretive analyses comparing third country legislation with EU law, as well as the issuance of opinions, communications,

<https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1238_esma_advises_on_extension_of_aifmd_passport_to_non-eu_jurisdictions_0.pdf?>

¹³⁹ Commission Implementing Decision (EU) 2019/1277 of 29 July 2019 Repealing Implementing Decision 2012/630/EU on the Recognition of the Legal and Supervisory Framework of Canada as Equivalent to the Requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies, [2019] OJ L 201.

¹⁴⁰ 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 L146/1.

¹⁴¹ Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L302/1.

and supervisory expectations, all of which constitute typical forms of soft law¹⁴². At the same time, this ever-evolving legal framework serves as the very benchmark against which third country regimes are assessed for equivalence. This dual function means that ESMA is both the technical arbiter evaluating 'equivalence' and the de facto architect of the standards being assessed. The ESMA's technical outputs, though often formally non-binding, shape the interpretation of legislative requirements, standardise supervisory expectations and narrow the range of acceptable regulatory variation. Ongoing monitoring and soft rule-making therefore operate together: the former requires a benchmark, and the latter progressively supplies one. Consequently, ESMA holds not only rule-making authority within the European Union but also exerts extraterritorial normative influence on third country regulatory frameworks. It thus acts as a pivotal conduit for the projection of EU legal templates beyond its borders.

The four functions identified above describe the principal channels through which ESMA acts within the equivalence regime, while the following internal and external dimensions is analytical rather than classificatory in the same sense. The following paragraphs show how the same functions produce two broader effects: internally, they contribute to the centralisation of supervisory authority within the Union; externally, they embed ESMA in bilateral and multilateral networks of technocratic coordination beyond it.

2.4.2 Internal Consolidation through Technocratic Authority

Established in the aftermath of the global financial crisis, the ESMA represents a decisive shift in the governance of EU financial markets. As Moloney observes, ESMA is a coordination-oriented, soft-law based authority whose emergence reflects the post-crisis political consensus that financial supervision required stronger risk identification

¹⁴² In the famous *Meroni, Romano and Short-Selling* judgments, the Court of Justice of the European Union has ruled that soft rule-making powers may be delegated to European Supervisory Authorities (including ESMA), but this must be limited to clearly defined executive powers and cannot be extended to powers involving broad discretion. See *Case 9/56 Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community* [1957–58] ECR (English Special Edition) 133, 152 and 154, ECLI:EU:C:1958:7; *Case 10/56 Meroni & Co., Industrie Metallurgiche, società in accomandita semplice v High Authority of the European Coal and Steel Community* [1957–58] ECR (English Special Edition) 157, 172–173, ECLI:EU:C:1958:8; *Giuseppe Romano v Institut national d'assurance maladie-invalidité* (Case 98/80) [1981] ECR 1241, para 20; OJ C 137, 6 June 1981, 6–7; *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union* (Case C-270/12) EU:C:2014:18, paras 41–53; OJ C 85, 22 March 2014, 4.

mechanisms, more intrusive oversight, and firmer enforcement powers¹⁴³. The expansion of ESMA's mandate was not merely institutional, but normative: it embodied a transformation in the conception of financial market regulation and the public interests it serves, with financial stability elevated to a central organising objective.

The internal dimension of ESMA's role within the equivalence regime concerns the way in which these functions reallocate supervisory authority upward from the national to the Union level. This process is not a formal transfer of competences in the constitutional sense. Rather, it takes place through the cumulative operation of registration mechanisms, technical standards, advisory filtering and post-decision monitoring, all of which reduce the room for Member State divergence and reinforce a single EU approach to third-country access.

Where access to the single market depends upon EU-level recognition and registration, Member States no longer act as the principal arbiters of third-country access. The regulatory judgment is instead mediated through ESMA's technical assessment and through registers maintained at Union level. The same dynamic appears in ESMA's soft rule production. Through varied soft instruments, ESMA reduces interpretative fragmentation and channels supervisory expectations into more uniform forms. Technical advice to the Commission reinforces this internal dynamic because it contributes to the production of a single Union-level assessment of third-country comparability, replacing the possibility of multiple national readings with one expert-mediated framework of evaluation. The Commission retains legal authority, but ESMA's technical position structures the terms on which that authority is exercised. Ongoing monitoring completes this internal architecture. By monitoring regulatory developments, processing supervisory information and issuing soft guidance, ESMA ensures that equivalence remains linked to an evolving Union-level benchmark rather than a one-off static determination. At the same time, the assessment of third-country regimes against that benchmark contributes to the further standardisation and centralisation of EU regulatory rules, thereby reinforcing the development of the single rulebook as a stable and comparable supervisory framework.

143 Niamh Moloney, *The Age of ESMA: Governing EU Financial Markets* (Hart Publishing 2018) ch 1.

2.4.3 External Coordination through Technocratic Community

Beyond its internal centralising effects, ESMA's functions within the equivalence framework acquire an outward-facing dimension. Because equivalence governs third-country access to the EU single market, its operation necessarily entails structured interaction with external regulatory systems. The technical assessment of comparability, the negotiation of supervisory cooperation arrangements, and the ongoing monitoring of regulatory alignment all require sustained engagement with third-country authorities.

This external dimension may be understood in two forms. The first is bilateral engagement with third-country authorities through direct supervisory contact, negotiated understandings and co-operation arrangements. The second is multilateral engagement through participation in broader technocratic and standard-setting networks such as IOSCO. In both forms, the functioning of equivalence depends more upon the operation of epistemic communities sharing common technical vocabularies, methods and assumptions. As argued in Chapter 1, the deference model embedded itself within the transnational technocratic environment that has long underpinned international soft financial governance.

(a) Bilateral engagement with third-country regulators

At the bilateral level, ESMA maintains structured interaction with counterpart authorities in third countries whose entities seek access to the Union market. Such interaction matters not only because it supplies information relevant to equivalence assessments, but also because it creates channels through which legal asymmetries can be managed administratively. Where regulatory frameworks are not fully aligned, co-ordination may still be made workable through shared supervisory understandings, practical accommodations and ongoing dialogue between technocratic actors. This dynamic is usefully illuminated by epistemic communities theory, which explains how shared professional knowledge, common causal beliefs and broadly convergent normative frameworks can support cross-border policy coordination and regulatory co-operation. The epistemic networks connecting technocratic authorities have therefore strengthened ESMA's capacity to engage third-country authorities even in the increasingly restrictive setting of the equivalence regime, particularly where such engagement helps mediate the tensions created by the extraterritorial application of EU law.

A notable example is the operational understanding reached between ESMA and the PBoC, under which a no-objection letter issued by the central bank functions as a substitute for a bilateral recognition mechanism not yet codified in Chinese primary legislation. This reflects the flexibility of coordination that can emerge among technocratic actors under conditions of institutional incompleteness.

In 2022, under the EMIR framework, the European Commission formally recognised the Shanghai Clearing House (hereinafter SHCH) as an equivalent third country CCP, subject to its supervision by the People's Bank of China (hereinafter PBoC)¹⁴⁴. It is worth noting that under the equivalence provisions of EMIR, one of the preconditions for recognising a third country as equivalent is that its legal and supervisory arrangements must include an effective mutual recognition mechanism; specifically, 'the legal and supervisory arrangements of a third country must include an effective equivalent system for the recognition of CCPs authorised under other third country legal regimes'¹⁴⁵. This provision reflects the European Union's emphasis on reciprocity in the equivalence process, requiring that third countries not only maintain regulatory frameworks that are substantively equivalent, but also provide institutional openness to CCPs established under European Union or other third country legal systems.

However, a formal gap remains on the Chinese side. As of 2022, China's primary legislation, such as the Futures and Derivatives Law, did not explicitly provide for a legal framework enabling the mutual recognition of foreign CCPs. In principle, this absence should constitute a barrier to equivalence recognition under the EU framework. In response, the European Commission and ESMA adopted an administrative approach that effectively substituted formal legislative provisions with regulatory assurances: they accepted a no-objection letter issued by the PBoC as a de facto commitment to the mutual recognition obligation. In its assessment, the Commission acknowledged that China had not yet established a formal mutual recognition regime but concluded that 'there is no indication that the PBoC will misuse its discretion'. Accordingly, the Commission treated the PBoC's statement as an administrative expression of China's intent to comply with the reciprocity

¹⁴⁴ At present, the European Commission has only recognised central clearing arrangements for derivatives contracts overseen by the People's Bank of China (hereinafter PBoC). Security-based derivatives under the supervision of the China Securities Regulatory Commission (hereinafter CSRC) have not yet been brought within the scope of equivalence determinations. This reflects China's institutional separation between futures and derivatives regulation – similar to the European Union's differentiated approach to granting equivalence to the CFTC and the SEC in the United States.

¹⁴⁵ Article 25(6)(b), EMIR.

requirement, thereby completing the equivalence-based mutual recognition at the administrative-order level.

In this process, administrative orders and soft rules played a crucial role in supplementing formal legal frameworks. Although the no-objection letter issued by the PBoC does not possess binding legal force in the form of statutory provisions, the European Commission and ESMA interpreted it as a formal expression of regulatory intent and institutional alignment, thereby accepting it as a substitute fulfilment of one of the equivalence conditions. This approach, namely substituting legislative text with administrative instruments, reflects a technocratic preference for regulatory effectiveness and operational capacity over formal legal symmetry. The case thus becomes evident that, in the European Union's equivalence assessments of third countries, the expert consensus reached among technocratic actors often serves as the functional foundation of the regime.

While the arrangement demonstrated the functional flexibility of the EU's equivalence practice, it also exposed the thin institutional basis on which such coordination sometimes rests.

The arrangement was therefore workable in practice, but when compared with a formal framework of reciprocal treatment embedded in law, it provides a much weaker degree of transparency, generality or institutional security. Because access depended on the expectation that the PBoC would issue a no-objection letter to EU firms, rather than on a general legal mechanism guaranteeing reciprocal treatment, the arrangement rested on a relatively thin institutional basis. Its effectiveness therefore depended less on any stable legal entitlement than on continuing supervisory trust, administrative practice and the durability of the cooperative relationship. This may raise concerns in terms of legal certainty, transparency and long-term predictability because what it offered was not so much a framework-based channel of access as a relationship-based one, even if the arrangement was workable in practice and reduced the need for strict formal symmetry.

(b) Multilateral engagement through international technocratic networks

At present, ESMA, like the European Commission, participates in IOSCO as a non-voting associate member. However, unlike the Commission, ESMA has been granted 'permanent

observer' status on IOSCO's Board of Directors, which reflects its distinctive technical expertise and professional authority in securities market regulation¹⁴⁶. Within the FSB, ESMA has established a dedicated technical working group and actively participates in several informal mechanisms designed to support global regulatory coordination. Of particular importance is its involvement in the Over-the-Counter Derivatives Regulators' Group and the Over-the-Counter Derivatives Regulators' Forum¹⁴⁷. Through this multilateral platform, ESMA collaborates with regulatory authorities from other major jurisdictions to advance the implementation of the G20 OTC derivatives market reform agenda and to foster the gradual convergence of cross-border supervisory rules at the level of regulatory enforcement. Additionally, ESMA actively engages in the work of the CCPMI–IOSCO, aiming to exert technical influence over the development of financial market infrastructure standards and thereby bolstering the European Union's institutional discursive authority in international standard setting¹⁴⁸.

Participation in IOSCO and related international networks also places ESMA within a broader transnational community of securities regulators, one organised less through formal hierarchy than through technical exchange, soft standards and shared professional understandings. This multilateral setting matters for the equivalence regime because the practical meaning of comparability is not generated exclusively within EU law. It is also shaped by internationally circulated supervisory concepts, common methodologies and recurrent forms of expert consensus.

ESMA's role within multilateral financial governance should be understood first through its contribution to the internalisation of international standards within the EU legal order. In the development of the extensive administrative rulebook under EMIR, ESMA drew heavily on its interactions with third country regulatory authorities and on international standards, reports and templates, such as the principles outlined in the 2014 OTC Derivatives Market Reforms report¹⁴⁹. Most importantly, in the context of CCP recognition, the Union made adherence to the CPMI-IOSCO Principles for Financial Market Infrastructures (PFMI) a formal precondition for granting equivalence to third-country regimes. In this way, standards originally developed within the international soft law

¹⁴⁶ Pierre-Henri Conac, *The European Union's Role in International Economic Fora: Paper 6 – The IOSCO Study* (European Parliament 2015).

¹⁴⁷ *ibid.*

¹⁴⁸ *ibid.*

¹⁴⁹ See Niamh Moloney, *EU Securities and Financial Markets Regulation* (Oxford University Press 2014).

network were not left at the level of non-binding coordination, but were incorporated into a framework that attached concrete legal consequences to their observance. Through the equivalence architecture, international standards thus became benchmarks of regulatory acceptability and conditions of market access within the EU order.

This helps explain why equivalence can be understood as a particularly important institutional expression of deference in post-crisis international financial governance. Because it is anchored in internationally recognised baseline standards while reinforced through mechanisms of recognition, monitoring and possible withdrawal, equivalence provides precisely the kind of institutional discipline that soft law coordination alone often lacks. It does not displace the international regulatory network, but rather strengthens its practical operation by transforming shared standards into legally consequential criteria for cross-border access.

Against that background, ESMA's participation in multilateral financial forums acquires a further significance. ESMA was also positioned to use IOSCO, the FSB and CPMI–IOSCO as channels through which the EU's more specific regulatory approaches could be rendered influential internationally. Within a multilateral governance architecture, ESMA leverages international organisational platforms to advance cross-jurisdictional regulatory coordination. By embedding EU regulatory norms into the international rule-making process, it promotes their 'uploading' as global standards, while using the consultative mechanisms of multilateral procedures to reduce institutional frictions, and strengthen the external applicability and influence of the European Union's regulatory paradigm. Consequently, by enhancing its professional influence within international technical working groups, ESMA not only facilitates the institutional embedding of EU rules into multilateral agendas, but also creates the institutional space necessary for 'uploading' these rules as globally accepted standards¹⁵⁰.

In this multilateral context, ESMA does not simply receive norms from the outside. Nor does it merely export EU standards in a straightforward hierarchical manner. Its position is more complex. By participating in international standard-setting discussions while simultaneously administering the Union's equivalence regime, ESMA occupies a mediating role between global soft-law discourse and EU market-access governance. It draws upon

¹⁵⁰ Niamh Moloney, *The Age of ESMA: Governing EU Financial Markets* (Hart Publishing 2018), ch. 6.

international regulatory language to support the credibility of equivalence assessments, while also projecting EU supervisory expectations outward through the conditions attached to third-country recognition. In this sense, ESMA's multilateral engagement reinforces the outward dimension of the regime by embedding EU equivalence within a wider field of technocratic norm formation.

2.5 Conclusion

This chapter has argued that the EU equivalence regime should not be understood as a neutral or purely technical mechanism for recognising third-country rules. Nor is it adequately described as a simple market-access device. Rather, it is a fragmented, sector-specific and risk-sensitive framework through which the Union manages conditional reliance on third-country regulatory and supervisory systems. Equivalence is therefore best understood as a form of selective managed reliance: it enables the EU, in certain legislative contexts and under unilateral conditions, to defer to third-country arrangements for limited legal purposes, while retaining broad discretion over the scope, intensity and continuity of that reliance.

The chapter has further shown that the practical evolution of this regime has been increasingly shaped by financial stability. Although equivalence remains formally framed in the technically language of comparable outcomes, its operation is not neutral as between all forms of cross-border activity. The structure, intensity and conditionality of the regime reflect a broader post-crisis shift in EU financial law, in which external openness is increasingly filtered through prudential and systemic concerns. Financial stability therefore does not merely appear as one consideration among others. It functions as a central organising principle that helps explain why equivalence is available in some areas, more restrictive in others, and increasingly tied to monitoring, review and the possibility of withdrawal.

A further conclusion of the chapter is that equivalence has important internal institutional consequences. Internally, by conditioning third-country access on Union-level assessment, registration, supervisory co-operation and follow-up action, the regime contributes to the upward reallocation of regulatory authority within the EU. Equivalence is thus not only a mechanism for governing relations with external jurisdictions but also a vehicle through

which the Union consolidates its own supervisory centre. In this process, ESMA has emerged as a key technocratic actor. Through its role in registration, technical advice, ongoing monitoring and soft rule-making, ESMA helps translate the regime's underlying logic into concrete forms of operational control and reinforces the centralisation of supervisory authority at EU level. Yet its significance is not confined to the Union's internal architecture. ESMA also operates externally through bilateral engagement with third-country regulators, where technical consensus, supervisory trust and co-operative arrangements help render cross-border reliance workable even under conditions of legal asymmetry, and through active participation in multilateral regulatory networks, where it contributes to the internalisation of international standards while also providing a channel through which EU regulatory preferences may be projected outward. The equivalence framework therefore reveals the close connection between external financial governance, internal supervisory centralisation and the wider technocratic networks through which regulatory influence is exercised across jurisdictions.

The discussion in the next two chapters builds on this analytical foundation by turning from the general logic and institutional operation of the regime to its expression across particular legislative sectors. The purpose of Chapters 3 and 4 is not to catalogue every equivalence provision across the EU financial acquis, but to examine those parts of the regime in which equivalence is legally and politically more distinctive, and in which the Commission's discretionary judgment plays a more visible role. For that reason, the analysis does not focus on areas such as accounting standards recognition or the relatively broad prudential recognitions granted under the CRR/CRD framework in respect of certain exposures, infrastructures or entities. Those examples are undoubtedly part of the wider equivalence landscape, but they generally concern lower-risk or more technical forms of recognition that are more readily granted because they facilitate market efficiency and help reduce unnecessary fragmentation without raising the same intensity of prudential or strategic concern. The following chapters therefore concentrate instead on the more differentiated and contested parts of the regime, where equivalence operates as a more selective instrument of external governance and where the Union's balancing of risk, discretion and regulatory control becomes most clearly visible.

CHAPTER 3: EQUIVALENCE REGIME IN THE EUROPEAN MARKET INFRASTRUCTURE REGULATION AND THE MARKETS IN FINANCIAL INSTRUMENTS REGULATION

3.1 Introduction

Having established in Chapter 1 the legal design and institutional architecture of the European Union's equivalence regime, and in Chapter 2 the pivotal role of the European Securities and Markets Authority (hereinafter ESMA) as its technocratic authority, this chapter turns to the sectoral application of equivalence in the Union's core financial legislation. The focus lies on two frameworks that have most extensively developed and operationalised the regime: the European Market Infrastructure Regulation (EMIR) and the Markets in Financial Instruments framework (MiFID II/MiFIR). Together, these regimes govern the central pillars of modern financial markets—derivatives clearing and securities trading—and therefore constitute the areas where equivalence has acquired its greatest practical significance and systemic implications.

The importance of these domains is twofold. First, both EMIR and MiFID II/MiFIR emerged directly from the post-crisis reform agenda initiated by the G20, aimed at enhancing transparency, stability, and accountability in global financial markets. They thus provide the most visible instances of how international soft-law commitments have been transposed into EU law and subsequently embedded within the equivalence framework. Second, by covering infrastructures such as central counterparties (CCPs), investment firms, and trading venues, these frameworks expose the EU to direct cross-border interdependencies. The recognition or non-recognition of third country entities in these areas has immediate consequences not only for market access but also for financial stability and the global allocation of trading activity.

By tracing the operation of equivalence across EMIR and MiFID II/MiFIR, this chapter shows how the regime has evolved into a powerful instrument of EU external financial governance. It illustrates the mutually reinforcing dynamic between regulatory centralisation and the construction of the Single Rulebook, while also highlighting the strategic dimension of equivalence as a means of managing systemic interdependence and asserting the European Union's position in global financial markets.

3.2 Equivalence Regime in the European Market Infrastructure Regulation

3.2.1 Background and Regulatory Scope of the European Market Infrastructure Regulation

The European Market Infrastructure Regulation (hereinafter EMIR) is a crucial regulation enacted by the European Union (hereinafter EU) following the 2008 global financial crisis to enhance the transparency and stability of financial markets. The European Market Infrastructure Regulation primarily focuses on over-the-counter (hereinafter OTC) derivatives transactions, central counterparties, and trade repositories (hereinafter TRs). Its core objectives are to reduce systemic risk and increase market transparency. Through a series of measures outlined in EMIR, the European Union aims to mitigate systemic risk in financial markets, improve market transparency, and foster the safety and stability of the derivatives market.

The European Market Infrastructure Regulation's introduction was a direct response to commitments made at the Group of Twenty (hereinafter G20) Pittsburgh Summit held in the United States in 2009. The summit emphasised the fact that '[a]ll standardized OTC derivative contracts should be cleared through central counterparties, and all derivative transactions should be reported to trade repositories'¹⁵¹.

Consequently, EMIR represents a part of the global derivatives regulatory coordination mechanism. Its scope extends beyond the European Union's internal borders, also covering interactions with financial institutions in third countries (e.g., through equivalence mechanisms).

3.2.1.1 Group of Twenty Summit Consensus

Prior to the 2008 global financial crisis, the OTC derivatives market operated largely outside the scope of formal regulation. Transactions were conducted bilaterally between counterparties and outside organised, regulated trading venues. There were no mandatory central clearing obligations, and only minimal requirements for risk mitigation and reporting. As acknowledged by the United Kingdom (hereinafter UK) Financial Services

¹⁵¹ Group of Twenty (G20), Leaders' Statement: The Pittsburgh Summit (Pittsburgh, 24–25 September 2009).

Authority (hereinafter FSA) in the *Turner Review*¹⁵², there had been a prevailing assumption that participants in the derivatives market were sufficiently sophisticated and, therefore, did not require further regulatory protection. In this context, self-regulation remained the dominant approach in the OTC derivatives space.

The challenges in the OTC derivatives market stemmed largely from its pervasive lack of transparency, particularly in the credit default swap (hereinafter CDS) segment.¹⁵³ This opacity contributed to the accumulation of risk and its rapid transmission across the financial system. The outbreak of the 2008 global financial crisis, marked by widespread defaults on subprime mortgage-backed securities (hereinafter MBS), triggered substantial credit event payment obligations under associated CDS contracts. Given the difficulty market participants faced in accurately assessing counterparty exposures, which was exacerbated by the complexity and interconnectivity of CDS contract chains, trust between financial institutions eroded sharply. This led to a severe contraction in market liquidity and heightened the threat of systemic risk.

Following the global financial crisis, the G20 reached landmark consensus on reforming the global derivatives market at the 2009 Pittsburgh Summit. This agreement is widely regarded as a pivotal turning point in global financial regulatory reform, particularly with respect to the OTC derivatives sector.

At the Pittsburgh Summit, the G20 adopted four core commitments regarding the reform of the derivatives markets¹⁵⁴:

- *Central clearing*: 'Cleared through central counterparties by end-2012 at the latest.'
- *Trading transparency*: 'Traded on exchanges or electronic trading platforms, where appropriate.' All standardised contracts should be traded on organised trading venues, such as Multilateral Trading Facilities (hereinafter MTFs) or Organised Trading Facilities (hereinafter OTFs), in order to enhance market transparency.

¹⁵² Financial Services Authority (FSA), *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009) London
<http://www.actuaries.org/CTTEES_TFRISKCRISIS/Documents/turner_review.pdf>

¹⁵³ F Partnoy and D Skeel, 'The Promise and Perils of Credit Derivatives' (2007) 75 *U of Cincinnati LR* 1036.

¹⁵⁴ Basel Committee on Banking Supervision, Committee on Payments and Market Infrastructures, Financial Stability Board and IOSCO, 'Incentives to Centrally Clear Over-the-Counter (OTC) Derivatives: A Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms' (7 August 2018) <<https://www.fsb.org/wp-content/uploads/P070818-1.pdf>>

- *Reporting obligations:* 'OTC derivative contracts should be reported to trade repositories.' All OTC derivative contracts must be reported to TRs to enable regulatory authorities to monitor systemic risk more effectively.

Capital requirements: 'Non-centrally cleared contracts should be subject to higher capital requirements.' OTC contracts that are not centrally cleared should be subject to higher capital charges to reflect their greater counterparty credit and liquidity risk.

Following the political consensus reached at the G20 level, the European Union undertook a series of complementary regulatory reforms to implement the commitments outlined by the G20. The 2013 Capital Requirements Directive IV/Capital Requirements Regulation package, which transposed the Basel III framework into EU law, introduced higher capital requirements for non-centrally cleared derivative contracts. Under the Markets in Financial Instruments Directive II/Markets in Financial Instruments Regulation (hereinafter (MiFID II/MiFIR) framework, the creation of tiered multilateral trading platforms facilitated a quasi-on-venue environment for OTC derivatives, contributing to their gradual standardisation. In the meantime, trade reporting and central clearing obligations were delegated to the EMIR. More broadly, the tightening of prudential supervision over investment firms and the imposition of enhanced risk management requirements reflected a growing policy concern with the systemic risks posed by derivatives markets. Taken together, these reforms constitute what can reasonably be described as a regulatory paradigm shift in the oversight of OTC derivatives within the European Union.¹⁵⁵

To enhance trading transparency, EMIR mandates that all OTC derivative transactions must be reported to registered TRs. This requirement establishes a centralised data infrastructure, enabling regulatory authorities to monitor market developments more effectively. In terms of systemic risk mitigation, EMIR imposes a mandatory central clearing obligation via authorised CCPs on eligible contracts. For non-centrally cleared derivatives, the regulation introduces alternative risk mitigation techniques, including the exchange of collateral (margin requirements), regular portfolio reconciliation, and mark-to-market valuation.

¹⁵⁵ Niamh Moloney, *EU Securities and Financial Markets Regulation* (ch VI.4 3rd edn, Oxford University Press 2014).

To strengthen supervisory capacity, EMIR also confers powers on the ESMA to oversee third country CCPs, TRs and related entities. This extends the jurisdictional reach of EU financial regulation beyond its internal market and reinforces ESMA's role in cross-border oversight.

3.2.2.2 Remit of over-the-counter derivatives

At the G20 Summit held in Pittsburgh in September 2009, leaders made the commitment that by the end of 2012, all 'standardised OTC derivative contracts' would be traded on exchanges or electronic trading platforms and cleared through CCPs. They further agreed that OTC derivatives should be reported to trade repositories and that non-centrally cleared contracts would be subject to higher capital requirements.¹⁵⁶ This commitment implicitly presupposed a definition of OTC derivatives that distinguished them from exchange-traded instruments. However, in the EU context, this distinction is complicated by the introduction of MTFs and OTFs under the MiFID II/MiFIR framework. These new trading venue categories blur the traditional boundary between 'on-exchange' and 'off-exchange' trading, thus necessitating a more precise conceptual clarification of what constitutes an OTC derivative in regulatory terms.

Derivatives can be traded either on exchanges or in the OTC market. Exchanges are typically regulated markets, offering designated trading venues for listed securities and other financial instruments. In contrast, the OTC market operates outside these formal venues and consists of a decentralised network of dealer banks and their trading systems. Acting as market makers, dealers quote buy and sell prices to other dealers or clients, often providing different prices to different trading counterparties.

As discussed below in the section on MiFID II/MiFIR in this thesis (see 3.2.2), the EU regulatory framework classifies trading venues into three categories: (1) Regulated Markets (hereinafter RMs), (2) MTFs and OTFs. Under this classification, only derivatives traded on RMs are considered exchange-traded derivatives (hereinafter ETDs), that is, *non-OTC*. By contrast, derivative contracts executed on MTFs or OTFs, although subject to

¹⁵⁶ Group of Twenty (G20) Pittsburgh Summit, 'Leaders' Statement, Strengthening the International Financial Regulatory System,' Pittsburgh 24–25 September 2009.

some level of regulatory oversight and transparency, are still classified as OTC derivatives for the purposes of EMIR.

The Markets in Financial Instruments Directive II/Markets in Financial Instruments Regulation introduced a clear distinction between exchange-based markets and the OTC space, thereby establishing a multi-tiered market structure within the European Union (see 3.2.2 below). Notably, however, the authority to assess the equivalence of third country regulated markets, that is, to determine whether such markets can be treated as functionally comparable to EU regulated markets, is exercised under the EMIR framework, rather than MiFID/MiFIR itself.¹⁵⁷

3.2.2 Clearing as Core of the European Market Infrastructure Regulation

The European Market Infrastructure Regulation exerts a significant market-shaping effect, primarily through its central provision: the central clearing obligation. This obligation constitutes the core of the EMIR framework¹⁵⁸.

The European Market Infrastructure Regulation addresses the clearing of derivatives through a two-pronged approach: (1) it imposes mandatory clearing obligations on specific derivative contracts (object-oriented focus) and (2) it establishes a regulatory framework for CCPs, which is the financial market infrastructure responsible for executing these clearing functions (entity-oriented focus). A comprehensive understanding necessitates considering both these interconnected aspects.

3.2.2.1 Clearing Obligation

Article 4 of EMIR establishes a mandatory clearing obligation for certain categories of OTC derivative contracts. This obligation requires that designated contracts must be cleared through a CCP, reflecting the European Union's implementation of the political commitments made at the G20 level. The rationale behind central clearing lies in its ability to enhance transparency for both market participants and supervisory authorities. By concentrating information and counterparty risk within CCPs, the clearing system

¹⁵⁷ Art 2(a) of 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 L201/1 (hereinafter EMIR).

¹⁵⁸ Nimh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, Oxford University Press 2014) 578.

facilitates more accurate assessments of market dynamics and improves the overall robustness of risk management practices.¹⁵⁹ The authority to determine the scope of derivatives subject to the clearing obligation has been conferred on ESMA.

(a) Types of derivatives that need to be centrally cleared

The European Market Infrastructure Regulation sets out two methods for determining the types of derivatives that are subject to clearing requirements. These are referred to as the (1) 'bottom-up approach' and (2) 'top-down approach'.¹⁶⁰

The *bottom-up approach* refers to a process whereby an authorised CCP proactively submits an application to the regulatory authorities concerned, indicating its readiness and operational capacity to clear a specific class of derivative instruments. This information is transmitted to ESMA, which, upon assessing the CCP's capabilities, may recommend that the European Commission impose a mandatory clearing obligation on that product class through the adoption of Regulatory Technical Standards (hereinafter RTS).

By contrast, the top-down approach is initiated by ESMA itself, which continually monitors the derivatives market, including products not currently cleared by any CCP. If ESMA determines that a particular product poses systemic risk and warrants mandatory clearing, it may propose to the European Commission that the product be brought within the scope of the clearing obligation.

It is evident that, whether under the bottom-up or top-down procedure, ESMA occupies a central role in the determination of the clearing obligation. EMIR also establishes a set of criteria that ESMA must take into account when assessing whether a class of OTC derivatives should be subject to mandatory clearing. These criteria include the degree of standardisation of the contract, the volume and liquidity of trading, the availability of clearing services from a CCP, and the potential for reducing systemic risk. In this way, EMIR not only lays down a legal framework of evaluation standards, but also delegates significant technical discretion to ESMA within defined boundaries. This institutional design exemplifies the logic of 'bounded discretion'; a regulatory approach commonly

¹⁵⁹ Hossein Nabilou and Ioannis G Asimakopoulos, 'In CCP We Trust . . . or Do We? Assessing the Regulation of Central Clearing Counterparties in Europe' (2020) 15 Capital Markets Law Journal 70.

¹⁶⁰ Article 5 EMIR.

employed in the EU financial supervisory architecture whereby expert authorities are granted decision-making power within a legally pre-defined scope.

The delegation of powers to ESMA under Article 5 of EMIR is grounded in several institutional and policy considerations. First, ESMA possesses the requisite technical expertise and neutrality to assess the complex structure of OTC derivatives, monitor market activity and liquidity, and evaluate the clearing capabilities of authorised CCPs. This centralised expertise mitigates the risk of regulatory capture or moral hazard, which could arise if clearing obligations were determined by market participants themselves.

Second, empowering ESMA prevents regulatory fragmentation and arbitrage across Member States. A decentralised approach to determining clearing obligations would likely result in divergent national standards, inconsistent CCP authorisation criteria and opportunities for forum shopping. The ESMA's role enables the European Union to maintain a uniform and coherent clearing framework, ensuring the stability and integrity of its post-crisis financial infrastructure.

Third, ESMA's centralised evaluation function facilitates the European Union's compliance with its international commitments, particularly the G20 Pittsburgh mandate to centrally clear all standardised OTC derivatives. It also enhances the European Union's ability to engage in cross-border regulatory co-operation, for instance, with the Commodity Futures Trading Commission (hereinafter CFTC), and supports the development of mutual recognition frameworks for third country CCPs and infrastructure.

Closely related to the clearing obligation is the derivatives trading obligation (hereinafter DTO), established under MiFIR. This obligation inherently involves the equivalence recognition of third country trading venues for derivatives. While the present thesis elaborates on these specifics within the MiFIR section, understanding the clearing obligation is a prerequisite. Without this foundational knowledge, comprehending the application of the DTO under MiFIR and its associated recognition mechanisms for third country trading venues becomes challenging.

The clearing obligation illustrates the remarkably broad extraterritorial reach of EMIR. Under EMIR, the obligation applies even to derivative contracts entered into between a

non-EU entity and an EU counterparty, where 'an entity established in a third country that would be subject to the clearing obligation if it were established in the Union'. Moreover, EMIR further provides that derivative contracts which have 'a direct, substantial and foreseeable effect within the Union', as well as transactions concluded with the purpose of evading EMIR, shall also fall within the scope of the clearing and risk-mitigation requirements¹⁶¹. Accordingly, irrespective of where the transaction takes place or where the counterparties are established, any derivative contract that is substantively connected to the EU market, or suspected of constituting regulatory avoidance, may be captured by EMIR. In practice, this means that clearing, reporting, and risk-mitigation rules apply not only where one counterparty is established outside the EU, but may also extend to contracts where both counterparties are established in third countries, thereby underscoring EMIR's significant extraterritorial effect.

(b) Supervision on central counterparties

Once ESMA has identified the specific classes of derivatives subject to the clearing obligation, those contracts must be centrally cleared through a CCP. When Lehman Brothers failed in 2008, the contrast between centrally cleared and uncleared derivatives became particularly visible. Despite extreme market conditions, LCH was able to hedge and close out Lehman's entire \$9 trillion cleared derivatives position in less than three weeks¹⁶². By contrast, claims by Lehman's uncleared derivatives counterparties amounted to approximately USD 51 billion, while the first tranche of payments to those creditors was made only four years later¹⁶³.

The relatively robust performance of CCPs during the financial crisis underscored their institutional advantages in risk mitigation and market stabilisation. This empirical lesson prompted regulators to place greater emphasis on the formalisation and expansion of central clearing mechanisms. Accordingly, in line with the political commitments made at

¹⁶¹ 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 L201/1, art 4(1)(a)(iv) - (v); Also see Commission Delegated Regulation (EU) No 285/2014 of 13 February 2014 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations [2014] OJ L85/1.

¹⁶² J Cunliffe, 'Central Clearing and Resolution: Learning Some of the Lessons of Lehman', speech, Bank of England, London, 5 June 2018 <<https://www.bis.org/review/r180606c.pdf>>

¹⁶³ Lucia Quaglia, 'International Standards for Derivatives Trading and Clearing' in Lucia Quaglia *The Politics of Regime Complexity in International Derivatives Regulation* (Oxford University Press 2020).

the 2009 G20 Pittsburgh Summit, member jurisdictions pledged that they would ensure that all standardised OTC derivative contracts would be cleared through CCPs.

As an important part of financial market infrastructure,¹⁶⁴ the role of the CCP can be described as a guarantor of contractual performance in functional terms. Only after both parties have reached a contract that has established each other's rights and obligations does the CCP come into play through a process called *novation* to place itself in the trading parties as a 'counterparty' to each other. Under novation, a contract achieved between two clearing participants is novated into two new independent contracts: the one between the CCP and seller and the other one between the CCP and the buyer.¹⁶⁵ In this way, CCPs assume the credit risks emerging in the trading. Even if a trading party defaults and is unable to fulfil its obligations under the original contract, the one CCP must pay its indebtedness to the other in accordance with its contract with the non-defaulting party. Since the two updated contracts are independent of each other, if the contract between the CCP and the breaching party cannot be performed, that cannot affect the performance of the contract between the CCP and the non-breaching party. CCPs thus become 'the seller to every buyer and the buyer to every seller and thereby ensuring the performance of open contracts.'¹⁶⁶

In addition, 'multilateral netting underlies the operation of the [CCP] arrangement'.¹⁶⁷ From the perspective of each clearing participant to the CCP, novation is 'bilateral'. When a holistic view is taken of the clearing process in which CCPs offer clearing services to all clearing members, the clearing network is 'multilateral'. For the sake of efficiency, CCPs do not clear each transaction on a single basis. Instead, they offset multiple claims and liabilities between clearing participants so that, ultimately, the trader only has one claim or liability to the clearing house. In this way, the clearing house reduces the number of transactions and the required volume of financial resources for clearing members to fulfil their contractual obligations. The gross bilateral contractual claims would be offset and a final single net claim to parties who still have the obligations to execute will be calculated.

¹⁶⁴ Bank for International Settlements, 'CPSS-IOSCO Principles for Financial Market Infrastructures' (Bank for International Settlements, April 2012).

¹⁶⁵ Iain G MacNeil, *An Introduction to the Law on Financial Investment* (Hart Publishing 2012).

¹⁶⁶ *ibid.*

¹⁶⁷ Benjamin Geva, 'The Clearing House Arrangement' (1991) 19 *Canadian Business Law Journal* 147.

Thus, CCPs act as nodes in financial transaction networks and connect all kinds of market participants together in a rather systematic way. By such a design, CCPs could, to a large extent, reduce the risk of a sudden market failure deriving from the default of an uncertain market player, which has been proven in the 2008 financial crisis where CCPs played an effective role in preventing failure contagions and stabilising finance.¹⁶⁸ By becoming the 'seller to every buyer' and the 'buyer to every seller,' CCPs assume the clearing obligation for the entire market and centralise counterparty credit risk onto themselves.

At the 2011 Cannes summit, G20 leaders agreed on posting margin requirements on non-centrally cleared derivatives.¹⁶⁹ in combination with some other indirect tools such as a lower risk-weighting assignment for banks' collateral exposure to CCPs,¹⁷⁰ in order to impulse central clearing over the derivatives market. So far, CCPs also extend their application scope into other financial instruments such as the repurchase agreement (hereinafter repo) market in addition to the derivatives market.¹⁷¹

It is no possible to eliminate market risks and what CCPs actually do is to allocate, even centralize, them. CCPs therefore become system-significate institutions in the financial market and relevant regulatory rules concerning CCPs are rising.

CCPs typically use three layers of financial resources to manage the risks to which they may be exposed: (1) membership requirements, (2) margin and (3) default funds:

First, clearing houses set high admission requirements to sort out their members, making sure that their members are well operated with abundant capital to reduce the default possibility.

Second, the internal rules of clearing houses set daily transaction guidelines to allow themselves enough financial resources to deal with market risks. The most common tools are margins, which could effectively supplement the risk exposure in the market.

¹⁶⁸ Lucia Quaglia, 'Chapter 1: Introduction'. *The Politics of Regime Complexity in International Derivatives Regulation* (Oxford University Press 2020).

¹⁶⁹ Group of Twenty (G20) Leaders Summit Cannes, Communiqué, Cannes, 3–4 November.

¹⁷⁰ Basel Committee on Banking Supervision, 'Bank for International Settlements The Group of Governors and Heads of Supervision Reach Broad Agreement on Basel Committee Capital and Liquidity Reform Package', press release plus Annexure, 26 July 2010.

¹⁷¹ Hal S Scott et al, 'Mandatory Central Clearing for U.S. Treasuries and U.S. Treasury Repos' (November 11, 2021) SSRN: <<https://ssrn.com/abstract=3961739> or <http://dx.doi.org/10.2139/ssrn.3961739>>

Since CCPs would be exposed to the potential credit risks derived from the trading counterparties for a period between when the transaction was launched and the transaction would be executed, the CCP would require clearing participants to pay the 'margins' to cover the exposure;¹⁷² that is to say, the clearing house would charge its members with margins while the members would also charge their terminal clients with this amount of margins. The margins can be categorised as *initial margin*, *variation margins* and *collaterals*, which should be covered by cash or high-liquidity collateral. Once members fail to satisfy the internal transaction rules, their positions would be closed out compulsorily to cover exposures and reduce risks. The repaid margins and collaterals would be used to cover the costs in the procedure.

Third, default funds constituted as a buffer in case of sudden failure happens in some clearing house members. It is jointly funded by members and when defaults happen, it could be consumed in a sequence (default waterfall) to cover exposures and end the contagious default in the market.

3.2.3 Equivalence Regime in Central Counterparties

In practice, the most significant application of the equivalence regime lies in the recognition of third country CCPs under EMIR. This area not only encapsulates the institutional features of the equivalence framework but also provides the richest source of case material for studying its operation. A third country CCP seeking to provide clearing services to EU clients is generally required to undergo a technical assessment by ESMA, on the basis of which the European Commission issues an equivalence decision. However, EMIR also provides for an exception: where a third country CCP offers services to EU clients only indirectly through its domestic clearing members, it is not required to obtain ESMA's recognition¹⁷³. Given the central importance of CCPs to financial stability, the equivalence determination of their regulatory frameworks must be made by the Commission in the form of an implementing act, relying on ESMA's technical advice. At the same time, the registration and authorisation of third country CCPs to access the EU market is exercised centrally by ESMA, a feature that stands in sharp contrast to other

¹⁷² J Cunliffe, 'Central Clearing and Resolution: Learning Some of the Lessons of Lehman', speech, Bank of England, London, 5 June 2018 <<https://www.bis.org/review/r180606c.pdf>>

¹⁷³ 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, recital 59..

areas of financial services. With the exception of CRAs and CCPs, most other equivalence regimes follow a “dual-track” model, whereby regulatory competences are shared between the EU level and the Member States.

The ESMA is responsible for providing the European Commission with technical assessments regarding the equivalence of third country regimes. It has characterised its approach as outcomes-based rather than rules-based, placing emphasis on solutions that minimise the risk of market disruption. This approach has proven to be sound in practice.¹⁷⁴ Before granting recognition to a third country CCP, extensive pan-European coordination is required. ESMA must consult a range of authorities concerned prior to making its recognition decision.¹⁷⁵ However, if ESMA's decision diverges from the opinions of those consulted, it is not subject to a formal veto or required to justify its position. Once equivalence has been granted, ongoing pan-EU supervision of the recognised third country CCP also falls within ESMA's mandate.

The European Commission applies three principal criteria when determining whether a third country regulatory regime may be considered equivalent, and whether CCPs established in that jurisdiction may be permitted to offer clearing services within the EU Single Market. These criteria are as follows¹⁷⁶:

- (a) The third country must impose legally binding requirements on CCPs that are effectively equivalent to the substantive provisions set out in Title IV of EMIR
- (b) There must be effective and ongoing supervision and enforcement in the third country, ensuring that regulatory requirements are consistently met in practice

The third country regime must include a system of legal reciprocity, whereby it recognises CCPs authorised in other jurisdictions under comparable equivalence frameworks.

In the following part, the article has concluded the basic rules for assessing equivalence in CCP area.

¹⁷⁴ Steven Maijor, 'EMIR: A Fair Price for Safety and Transparency', speech by the ESMA Chairperson, 27 March 2013 (ESMA/2013/428).

¹⁷⁵ EMIR, article 25(3)

¹⁷⁶ EMIR, article 25(6)

3.2.3.1 Equivalent Legally Binding Requirements for Central Counterparty Regulations

The International Banking Federation recommend that systemic risks inherent within CCPS should be addressed through proper regulations, including risk management tools (i.e., margin, transparency and risk control measures), CCP Membership Standards, the CCP capital requirement and the ability to obtain liquidity backup from central banks in emergencies.¹⁷⁷ It is common for jurisdictions to incorporate these regulatory dimensions into their legal doctrines to guide CCPs to operate in more stable surroundings. The legally binding requirements are the most important part of the three accessible criteria because it involves the specific rules for CCPs' daily operation and directly deal with market risks. A sound legally binding regulatory framework is the basis for effective ongoing supervisions, too.

In the comparative argument part, the European Commission would briefly introduce the regulatory framework in targeted jurisdictions primarily and then make a comparative analysis to determine if the unfamiliar regulatory scheme can achieve a substantive effect in its domestic financial market. Given the published decision contexts for 18 jurisdictions, the simple description of 'equivalent legally binding requirements' can be divided into the following concrete requirements:

(a) Equivalent regulatory architecture

Qualified equivalent jurisdictions should establish an integrated legal regulatory structure by various adequate pieces of legislation to achieve substantial financial stability in the domestic market. However, the European Union does not have any extra requirement that a high-level law in domestic legal hierarchy should be in place to act as the leading legislative rules of the whole regulatory framework. Commonly, equivalented jurisdictions publish specific Acts for derivatives regulating but there are still some exceptions. For example, in Hong Kong, the regulatory scheme for derivatives is upheld by the Clearing and Settlement Systems Ordinance, which is deemed lower than Acts in Chinese legal

¹⁷⁷ International Banking Federation, 'Response to Consultation on Bank Exposure to CCPs', London, 10 February 2011) <<https://www.bis.org/publ/bcbs190/internationalba.pdf>>; Lucia Quaglia, 'International Standards for Bank Capital Exposures to CCPs and Derivatives' in Lucia Quaglia The Politics of Regime Complexity in International Derivatives Regulation (Oxford University Press 2020).

hierarchy because it is not enacted by Parliament. In addition, the legally binding requirements of Switzerland for authorised CCPs is led by the National Bank Ordinance of 18 March 2004 although the Federal Act on Banks and Saving Banks also assists in regulating banking-related issues.

The regulatory scheme often consists of all kinds of acts, ordinances, directives or guidelines published by competent authorities to establish a detailed and flexible regulatory architecture. When the EU Commission assesses the whole architecture, it adopts an overall evaluation method and does not pose rigorous requirements of form.

(b) Clearly empowered competent authorities

The requirement for competent authorities is implicit in decision contexts and is quite necessary. Decision documents do not refer to clear-cut requirements in texts, but the assessment of the duty and administrative powers of competent authorities consist of an important part for the recognition of a substantial equivalent legally binding framework and effective ongoing supervision.

Jurisdictions would designate proper institutions as the competent authorities taking responsibility for regular supervision and issue technical operation guidelines or directives for CCPs in the market. In many jurisdictions, the competent authorities are also assigned rule-making power. Consequently, competent authorities actually share legislative power and shape the whole regulatory framework with their daily work. Explicitly designated competent authorities and clear-cut allocations of regulatory powers among them thus become prerequisites both for criteria 1 and 2.

As for the character of competent authorities, the European Commission does not take too much care. An analysis of 18 decisions shows that competent authorities can be central banks¹⁷⁸, sectoral administrative regulatory institutions or some other special entities taking

178 European Commission, Commission Implementing Decision (EU) 2022/174 of 8 February 2022 determining, for a limited period, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No. 648/2012 of the European Parliament and of the Council, L 28/40; Commission Implementing Decision (EU) 2015/2041 of 13 November 2015 on the equivalence of the regulatory framework of Mexico for central counterparties to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, L 298/38.

charge of certain aspects. Sectoral regulators are easily affected by parliament or government (e.g., in some countries, sectorial financial regulators are subsidiaries of governments). It seems plausible to say that the independence of competent authorities is not necessary in determining the equivalence of the third country regulatory regime. In the meantime, CPSS–IOSCO also adopt an unclear attitude towards this issue and do not set any limits on the identification of domestic competent authorities in its guidelines¹⁷⁹.

(c) Legal structure can be flexible but adopting international guidelines is necessary

Most equivalent jurisdictions have adopted a dual-tier legal structure in their domestic market to regulate the daily operation of CCPs. The primary rules are composed by national legislative instruments, such as acts, directives and orders from competent authorities, and the secondary rules are made up of CCPs' internal rules to self-regulate their daily business activities and member transactions in a more flexible and professional way. Compared with primary rules, internal rules tend to be more detailed and technical in respect of risk management tools such as margin, collateral, stress test and credit valuation adjustment model. The conclusion that can be drawn from the 18 decisions for different jurisdictions that have been analysed in this research, is that nearly all jurisdictions that have adopted such a dual-tier legal structure. Furthermore, once the internal rules have been accepted by competent authorities, those internal rules should be granted with legally binding effects according to domestic statutes, so that they become a part of the compulsory regulations. Therefore, if some members breach the internal rules of clearing houses, they could be sued in court or an administrative or criminal penalty can be imposed in addition to internal punishment imposed within the clearing houses.¹⁸⁰

However, although there are very few limits on formality requirements for CCP regulation, it is noticeable that all low-risk jurisdictions, and some not low-risk jurisdictions such as Switzerland, have announced that they comply with the PFMI issued by the CPSS–IOSCO. The international standards become a crucial regulatory source for those jurisdictions and also act as an imperative part of equivalence-granting criteria.

179 Lucia Quaglia, 'International Standards for CCPs' in Lucia Quaglia *The Politics of Regime Complexity in International Derivatives Regulation* (Oxford University Press 2020).

180 European Commission, Commission Implementing Decision (EU) 2016/377 of 15 March 2016 on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the Commodity Futures Trading Commission to the requirements of Regulation (EU) No. 648/2012 of the European Parliament and of the Council, L 70/32.

(d) Controlling power delegated to competent authority for central counterparties

Equivalent jurisdictions adopt near similar approaches to control CCPs' operational qualification and internal rule making ability. The controlling power entitles competent authorities to provide daily supervision of CCPs. This controlling power can be categorised into four types as follows:

First, clearing houses are required to register themselves in the necessary competent authorities in accordance with their clearing derivatives contracts. Without registration, CCPs are not allowed to take on the business of clearing. The competent authorities also command the withdrawal power for registered CCPs in case of serious breach of rules. Put simply, competent authorities control the 'life and death' of CCPs.

Second, competent authorities have the ability to censor the internal rules of CCPs to make sure that these internal rules remain consistent with national regulatory regulations and if there is any change about internal rules, CCPs have to inform the competent authorities concerned simultaneously. In addition to the censorship, regulatory agencies also have the right to impose extra rules on CCPs when they believe that they are necessary to protect the public interest¹⁸¹ or according to other situations stipulated in Acts.

Third, legislatures always enable competent authorities to give orders for CCP flexibly, directly instruct CCPs to assume certain duties such as reporting obligations or to set up internal control and risk control measures within changing market conditions.

Fourth, competent authorities have the authority to impose remedial measures in the case of regulated CCPs, including taking disciplinary actions such as imposing fines, administrative punishment, suing CCPs in court and obtaining adjudication to make up infringements caused by CCPs.

¹⁸¹ European Commission, Commission Implementing Decision (EU) 2015/2042 of 13 November 2015 on the equivalence of the regulatory framework of Switzerland for central counterparties to the requirements of Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, L 298/42.

3.2.3.2 Ongoing Effective Supervision

Criteria 2 are aimed at allowing the legally binding requirements to actualise well in financial markets. In general, supervision involves risk-based examinations, including access to transaction information, on-site inspections, tests of compliance with prudential requirements under the legal regulatory framework, reviews of business activities, and the imposition of appropriate sanctions where necessary.

Among these surveillance aspects, the most crucial requirement is that the European Union be well informed about information on the daily operations in CCPs and that the European Union has the independent right to revoke the rights of unqualified CCPs. The former is a prerequisite for regulators to master the accurate marketing information and adopt adequate risk mitigation tools for financial stability, and the latter is one of the most compelling tools to make sure clearing houses comply with regulations properly.

There is no doubt that some jurisdictions also adopt other stricter supervisory rules in practice. In Mexico, the competent authorities also have the power to intervene directly in the personal management of CCPs. Other jurisdictions do not have a widely adopted common method and the equivalence assessment is taken on individual basis.

3.2.3.3 A similar recognition regime for third country central counterparties

As a reciprocal arrangement, the European Commission requires that the applied jurisdictions have a reciprocal regime offering accessibility to their domestic markets, thereby reducing unnecessary costs of obeying replicative rules and improving market efficiency. Commonly, operation arrangements or a Memorandum of Understanding (hereinafter MoU) needs to be signed between the European Union and the third country to assure that the equivalence of CCPs can be operated smoothly in one another's jurisdictions.

By advocating for the third country regime across jurisdictions, the European Union could promote the harmony of international financial regulatory systems and enable the subsequent regulatory dialogue between different judicial regions to be carried out in a more similar background. In the specific context of EMIR recognition of third-country CCPs, this external influence is especially clearly expressed, since reciprocity is expressly built into the statutory conditions for equivalence. Under Article 25(6) EMIR, the

Commission may adopt an equivalence decision only where the third-country framework includes an effective equivalent system for the recognition of CCPs authorised under third-country legal regimes¹⁸²..

In the recitals to its decisions, the Commission explicitly states that the adoption of an equivalence determination is based not only on a comparative analysis of legal provisions across jurisdictions, but also on the substantive outcomes required by financial markets and the ability to sufficiently reduce risk, in order to safeguard the safety and stability of clearing members and trading venues established within the European Union.¹⁸³

Furthermore, where a jurisdiction is classified as low-risk based on its relatively limited transaction volume, the Commission acknowledges this special status in the recitals¹⁸⁴ and applies a more flexible approach in assessing whether its legal and supervisory framework can be considered equivalent. This is justified on the basis that participants from such low-risk jurisdictions are deemed to pose materially lower risks to EU clearing members and trading venues than would participants from third country CCPs formally authorised under EMIR.¹⁸⁵

It can thus be concluded that the central objective of the three equivalence criteria is risk reduction, which lies at the heart of the entire third country equivalence regime. The European Commission adopts an outcomes-based approach when granting equivalence. In practice, this results in a two-tier classification of equivalent jurisdictions. Countries with limited clearing volumes in derivative markets may be treated as entry-level jurisdictions, subject only to general requirements. By contrast, jurisdictions with significant market influence, such as the United States and the United Kingdom, are approached with greater

¹⁸² Corresponding reciprocity-oriented provisions can also be observed in the relevant recognition adopted by third countries themselves. See, eg, HM Treasury, Explanatory Memorandum to The Central Counterparties (Equivalence) Regulations 2020, paras 6.6-6.8, 7.5; Securities and Futures Ordinance (Hong Kong) (Cap 571), s 37 ('Recognition of clearing house') and Securities and Futures Commission (Hong Kong), Frequently Asked Questions on the Implementation and Operation of the Mandatory Clearing Regime (October 2025) Q 31; Commodity Exchange Act, 7 USC § 7a-1(h); Exemption from Derivatives Clearing Organization Registration, 86 Fed Reg 949, 968 (7 January 2021) (codified at 17 CFR § 39.6(a)(1)–(2)).

¹⁸³ It would be stated in the first three paragraphs in those jurisdictions deemed low-risk markets, such as Hong Kong and Singapore.

¹⁸⁴ It is generally demonstrated as 'the significantly lower risks inherent in clearing activities carried out in financial markets that are smaller than the Union financial market should thereby, in particular, be taken into account' in each low-risk jurisdiction decisions'.

¹⁸⁵ Paragraph 12 of European Commission Implementing Decision on the equivalence of the regulatory framework of Hong Kong for central counterparties to the requirements of Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (2014/754/EU).

regulatory caution, and are typically subject to more detailed and tailored equivalence conditions.

A CCP established in a jurisdiction deemed equivalent must apply to ESMA for recognition.¹⁸⁶ In addition to the substantive equivalence assessment described above, the recognition process administered by ESMA requires the establishment of co-operation arrangements with the third country supervisory authority responsible for the TC–CCP. The co-operation arrangements must address: information-exchange mechanisms (between ESMA and third country competent authorities); ESMA notification mechanisms where authorisation conditions are breached; ESMA notification mechanisms where a CCP has been granted the right to provide clearing services to clearing members or clients established in the European Union; and procedures governing the co-ordination of supervisory activities, including on-site inspections.¹⁸⁷ Moreover, the third country in which the TC–CCP is established must be deemed to operate a system that is equivalent to EU standards in the fields of anti-money laundering and counter-terrorist financing.¹⁸⁸

A recognised TC–CCP may provide clearing services to clearing members and trading venues established in the European Union while remaining subject to home-country supervision and oversight.¹⁸⁹

3.2.4 The European Market Infrastructure Regulation Equivalence Regime: International Co-operation and Extraterritoriality Mitigation

Throughout the drafting of EMIR, the European Union consistently emphasised the importance of international convergence.¹⁹⁰ In particular, ESMA, in developing its extensive EMIR rulebook, drew heavily on dialogue with third country authorities, as well as on a wide range of international principles, reports and templates. This approach aimed to reflect and preserve the global nature of the OTC derivatives market, ensuring the global compatibility of the EU framework.¹⁹¹ The ESMA-managed Binding Technical Standards

¹⁸⁶ Article 25(2) EMIR.

¹⁸⁷ Article 25(7) EMIR.

¹⁸⁸ Article 25(2)(d) EMIR.

¹⁸⁹ Article 25 (1) EMIR.

¹⁹⁰ See EMIR Recital 6.

¹⁹¹ Recognising the global nature of the OTC derivatives market, both the 2012 ESMA EMIR Draft BTS Report (n 445, 7) and Commission Delegated Regulation 149/2013 (rec 2) advocate for the integration of globally agreed guidelines and recommendations to foster regulatory convergence.

(BTS) regime incorporates recommendations issued by the Financial Stability Board (hereinafter FSB) on the implementation of OTC derivatives market reforms, along with relevant guidance and standards concerning mandatory clearing obligations and the regulation of central counterparties.¹⁹²

At the legislative level, specific provisions within EMIR also reflect a commitment to supporting global regulatory convergence; for example, the decision not to fully exempt non-financial counterparties was due in part to the prior stance adopted by the United States, which similarly chose not to grant a complete exemption to such participants.¹⁹³ Moreover, the EMIR framework was designed to support and enhance risk management practices in the OTC derivatives market. It therefore seeks to avoid replacing well-established market conventions with untested regulatory approaches.¹⁹⁴

In the field of international derivatives regulation, EMIR demonstrates significant extraterritorial reach. At the same time, the EU has sought to balance EMIR's far-reaching scope with mechanisms designed to avoid excessive conflict with third countries. In particular, EMIR's extraterritorial posture is tempered by the equivalence regime and related mitigating measures, which function as coordination tools to ease the rigidity of its reach and to facilitate international market access.

The EMIR extraterritorial effect also reflects the absence of mature international coordination in derivatives markets. Until now, international derivatives regulation remains highly fragmented and depends heavily on transatlantic dialogue between the EU and the United States¹⁹⁵. In the post-crisis context, both jurisdictions expanded extraterritorial oversight to guard against regulatory arbitrage and to secure control over major liquidity hubs, fuelling intense competition for regulatory authority. Against this backdrop, the equivalence regime has emerged as a crucial channel for cross-border market access and regulatory interaction, a role that will be examined in greater detail in Chapter 5.

¹⁹² Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, Oxford University Press 2014) 587.

¹⁹³ European Commission, 'Commission Staff Working Document Impact Assessment Accompanying the Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties and Trade Repositories (SEC (2010) 1058 15 September 2010) 7

¹⁹⁴ See, for example, Braithwaite, n 400 and Awrey, D, 'The Dynamics of OTC Derivative Regulation: Bridging the Public-Private Divide' (2010) 11 EBOLR 155.

¹⁹⁵ Elliot Posner, 'Financial Regulatory Cooperation: Coordination of Derivatives Markets' in Eric Helleiner, Stefano Pagliari and Irene Spagna (eds) *Governing the World's Biggest Market: The Politics of Derivatives Regulation after the 2008 Crisis* (Oxford University Press 2018) 54.

3.2.5 The European Market Infrastructure Regulation: A Gradually More Interventionist Approach to Equivalence

As outlined in previous sections, the European Union's equivalence regime was originally conceived under a deference model, effectively ceding a degree of territorial control to home-country regulators in order to promote international regulatory convergence and ease compliance burdens for cross-border firms. However, as Moloney observes, the equivalence regime is shifting from its previous compliance-based approach to a more restrictive and localised method.¹⁹⁶ The Brexit process marked a significant turning point, signalling a broader paradigm shift from deference to intrusiveness.

Following Brexit, the London Clearing House (hereinafter LCH) ceased to be directly supervised by EU authorities. However, the majority of euro-denominated interest rate swap (hereinafter IRS) clearing remained concentrated in London, raising concerns within the European Union regarding financial stability risks linked to excessive reliance on third country CCPs. In response, the European Union amended EMIR with the aim of gradually relocating certain systemically important clearing activities back to the European Union, using regulatory reforms to reduce dependence on United Kingdom-based and other third country CCPs.

Among the various amendments to EMIR, what stands out are the institutional and structural reforms introduced under EMIR 2.2 and, more recently, EMIR 3.0.

(a) European Market Infrastructure Regulation 2.2

Under EMIR 2.2, third country CCPs are classified into two categories: Tier 1 CCPs, which are those deemed *non-systemically important* and continue to be supervised under the original deference-based framework. In contrast, Tier 2 CCPs are those considered *systemically important* to the financial stability of the Union and are subject to enhanced oversight, as the European Commission intends to equip ESMA with stronger on-shore supervisory powers over these Tier 2 TC-CCPs.

¹⁹⁶ See Niamh Moloney, 'Third Countries and EU Financial Market Access: Technocracy, Politics, and the End of Deference?' in T Jaeger, M Lehmann, A Somek and M Waibel (eds), *Consolidating Brexit: The Future of EU/UK Cooperation* (Jan Sramek Verlag 2023) 203.

For these Tier 2 CCPs, the European Union adopted much more 'on-shore' and offensive supervisory methods. These CCPs must co-operate with the central banks of issue in the EU jurisdictions. Furthermore, the Tier 2 CCP must provide ESMA with a written statement, signed by its legal representative, in which it unconditionally consents to produce any documents, records, information and data requested by the authority.¹⁹⁷ This statement must be accompanied by the legal opinion of an independent expert certifying that the statement is valid and enforceable 'under the relevant applicable laws'.¹⁹⁸ Finally, the Tier 2 CCP must also have implemented all necessary measures and established all necessary procedures to ensure the effective compliance with the requirements by ESMA and the central bank(s) of issue.¹⁹⁹

These conditions must be fulfilled on an ongoing basis, which is assured through ongoing monitoring by ESMA. In addition, the supervisor must urge the Tier 2 CCP to repeat its confirmation at least once a year.²⁰⁰

With regard to Tier 2 CCPs, ESMA may not only examine records, data, procedures and other material and make copies of them, but also 'summon' the Tier 2 CCPs, their representatives or staff, interview natural or legal persons, and request records of data and telephone traffic.²⁰¹ The Tier 2 CCP is obliged to co-operate with the investigation and comply with any request.²⁰² In case it refuses to do so, EMIR provides for fines and periodic penalty payments.²⁰³

These far-reaching powers show a clear character of extraterritoriality. To mitigate the co-operative partners, EMIR also provides some restrictions on ESMA that (1) the home authorities have to be informed of any request or other measure taken by ESMA in relation to the third country CCP²⁰⁴ and (2) ESMA is obliged to coordinate the exercise of its powers with the authority of the third country.²⁰⁵

¹⁹⁷ Article 25(2b)(c) EMIR.

¹⁹⁸ Article 25(2b)(c) EMIR.

¹⁹⁹ Article 25(2b)(d) EMIR.

²⁰⁰ Article 25b(1) subpara 2 EMIR.

²⁰¹ Article 25g(1) subpara. 1 EMIR.

²⁰² Article 25f(4), 25g(3) and 25h(4) EMIR.

²⁰³ Article 25j and 25k EMIR.

²⁰⁴ Article 25f(5), 25g(4) and 25h(3) EMIR.

²⁰⁵ Article 25g(4) 2 and 3, Art 25h(5) EMIR.

The revision of EMIR has strengthened the regulatory framework for CCPs providing clearing services to EU firms. This is achieved by introducing a more risk-sensitive and proportionate approach for third country regimes.²⁰⁶

The criteria for assessing systemic importance are to be set out in delegated legislation adopted by the European Commission.²⁰⁷ Notably, 14 indicators are expected to be used to evaluate the nature, size and complexity of a CCP. These indicators include, for example, the volume and value of euro-denominated clearing activities, the CCP's degree of interconnectedness with the European Union (such as the proportion of its clearing members established within the Union) and the potential impact of the CCP's failure on EU financial stability. The ESMA, in consultation with the European Central Bank, is responsible for determining whether a CCP should be classified as systemically important or of substantial systemic relevance, while the European Commission retains the power to decide what action to take.²⁰⁸ The challenge lies in the fact that EMIR provides only vague guidance on what constitutes systemic importance and offers little detail on how ESMA is to conduct such assessments.²⁰⁹ As CFTC Commissioner Dawn Stump remarked, these indicators are 'subjective, qualitative, and grant ESMA excessively broad discretion'.²¹⁰

The European Union's shift is not limited to imposing stricter and more intrusive supervision on Tier 2 TC-CCPs. More significantly, in the course of strengthening its oversight of financial market infrastructure, the European Union has at times explicitly signalled its intention to require CCPs deemed systemically important to EU financial stability to relocate all or part of their business operations within the European Union. Lehmann refers to such entities as 'supra-Tier 2 CCPs'²¹¹, reflecting a category beyond Tier 2 that would trigger not only enhanced supervision, but also potential location requirements. Behind this initiative lies the European Union's desire to exercise more direct control and oversight over this critical market infrastructure in order to manage

²⁰⁶ European Commission, Communication from the European Commission to the European Parliament, the Council, the European Central Bank, the European economic and Social Committee and the Committee of the regions equivalence in the area of financial services, COM/2019/349 final.

²⁰⁷ European commission, Commission Delegated Regulation (EU) 2020/1303 of 14 July 2020.

²⁰⁸ Scott James and Lucia Quaglia, 'Brexit and the Political Economy of Euro-denominated Clearing' (2021) 28 *Review of International Political Economy*.

²⁰⁹ Dermot Turing, 'Clearing Away After Brexit?' Working Paper, Kellogg College, University of Oxford, 30 May 2020 rev February 2021).

²¹⁰ D Stump, 'From Pittsburg with Love: Dramatic Reforms, Ten Years Later', speech, D. (2019) <<https://www.cftc.gov/PressRoom/SpeechesTestimony/opastump4>>

²¹¹ Matthias Lehmann, 'Brexit and CCP Supervision: From Extraterritoriality to a Model of Shared Control', EBI Working Paper Series 2021 No. 101, 12 August 2021.

potential systemic risks more effectively. This concern became particularly acute after Brexit, as the continued clearing of large volumes of euro-denominated derivatives in London raised fresh stability concerns for the European Union.

However, the relocation initiative faced strong opposition from multiple stakeholders and was ultimately put on hold. Notably, resistance from London was particularly vocal.²¹² As a major global financial centre, London hosts a significant share of CCP activity, especially the clearing of euro-denominated derivatives. Relocating these operations to the European Union would not only entail substantial operational costs and technical challenges, but also risk fragmenting global market liquidity and undermining London's status as a clearing hub. Moreover, other major jurisdictions, including the United States,²¹³ expressed concern over such extraterritorial and mandatory relocation proposals, warning that they could trigger regulatory protectionism and destabilise the international financial system. Although the initiative has not been formally implemented, debate over the European Union's intention to enforce CCP relocation has persisted in market and policy circles.

Despite facing resistance, the European Union has continued to pursue its strategic objectives through legislative efforts such as EMIR 3.0, which introduces mechanisms such as the Active Account Requirement (hereinafter AAR). This measure is designed to incentivise market participants to clear a greater share of euro-denominated derivatives through CCPs established within the European Union.

This ongoing policy push demonstrates that, even though direct relocation faces significant operational and political obstacles, the European Union remains firmly committed to enhancing its control over core financial market infrastructure.

(b) European Market Infrastructure Regulation 3.0

According to the European Commission's proposals in December 2022 to reform EMIR (EMIR 3.0), counterparties subject to EMIR clearing obligations must hold 'active

²¹² See, for instance, UK Parliament Publications, 'EU Supervision of UK-based central counterparties after Brexit (EMIR 2.2)', 2019 <<https://publications.parliament.uk/pa/cm201719/cmselect/cmeuleg/301-lxx/30108.htm>>

²¹³ Brian D Quintenz, 'Keynote Address of Commissioner Brian D Quintenz before FIA Annual Meeting, Boca Raton, Florida', Boca Raton, Florida, 14 March 2018) US (Commodity Futures Trading Commission) <<https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz9>>

accounts' with European Union-based central clearing counterparties. In practice, this means that EU clearing participants, such as banks and investment firms, are required to open and maintain a minimum volume of euro-denominated derivative transactions, particularly for key standardised products such as interest rate swaps (hereinafter IRSs), with CCPs located in the European Union, in order to reduce reliance on third country CCPs, especially those in the United Kingdom. Furthermore, these counterparties must clear at least a specified proportion of such derivatives through EU CCPs, with the exact threshold to be set by ESMA²¹⁴.

European Market Infrastructure Regulation 3.0 imposes a requirement to open and maintain an 'active' account with a CCP established in the European Union on Financial counterparties and non-financial counterparties that are subject to the clearing obligation under EMIR and exceed the clearing threshold in any of the following derivatives: (1) interest rate derivatives denominated in the euro (hereinafter EUR) or the Polish zloty (hereinafter PLN) or (2) short-term interest rate derivatives denominated in EUR (in-scope counterparties). Contrary to the initial proposal, credit default swaps denominated in EUR have been excluded from the scope of this requirement.

Given the narrow scope of application of AAR under EMIR 3.0 and the extensive exemptions already embedded in EMIR (such as those for intragroup transactions and pension schemes), the policy impact of AAR has been significantly diluted. This reflects a gradualist regulatory approach, aligned with the structural realities of the post-Brexit clearing landscape.

Despite regulatory ambitions, the European Union remains heavily dependent on third country CCPs such as the LCH in the United Kingdom, which continues to dominate the clearing of euro-denominated interest rate swaps. In the absence of a fundamental shift in this structural dependence, any attempt to enforce a mandatory decoupling would not only be impractical, but could also result in market fragmentation, increased operational costs, and even systemic instability.

Accordingly, the European Commission's adoption of a symbolically strong yet operationally moderate AAR under EMIR 3.0 can be seen as a way to signal strategic

²¹⁴ COM (2022) 697.

autonomy goals externally, while preserving ample transitional space for market participants.

3.3 Equivalence Regime in Markets in Financial Instruments Directive II and Markets in Financial Instruments Regulation

Markets in Financial Instruments Directive II (MiFID II)²¹⁵ and Markets in Financial Instruments Regulation (MiFIR)²¹⁶ together provide the legal framework for securities markets, investment intermediaries and trading venues, forming a complementary relationship in terms of their functionality. Markets in Financial Instruments Directive II sets out conduct rules for investment firms and trading venues in financial instruments markets, while MiFIR ensures that these activities are open, transparent and fair across the EU market by establishing requirements for trade transparency and transaction reporting. In short, MiFID II focuses on regulating the behaviour and compliance requirements of market participants, whereas MiFIR primarily targets transparency and reporting rules for trades. Moreover, due to differences in legal form, MiFID requires implementation by Member States as it is a Directive, whereas MiFIR is directly effective as a Regulation.

3.3.1 Equivalence in Investment Firms and Services

The 2014 MiFID II/MiFIR regime fundamentally changed the regulatory framework for third country access to the EU market, primarily by enhancing the authority to manage access at the EU level centrally. Prior to this, under MiFID I, third country access through branches and cross-border services was a matter decided independently by each Member State and such access did not come with passporting rights. As a result, third country firms needed separate authorisation for entry in each Member State where they operated. When making decisions regarding the access of branches and services, Member States were not bound by uniform EU rules. Although Article 15 of MiFID I touched on the issue of third country access, it was primarily aimed at ensuring that EU companies received reciprocal treatment in third countries. In cases where EU investment firms faced barriers when entering third country markets, Article 15 empowered the European Commission, with

²¹⁵ 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 L173/349 (hereinafter MiFID II).

²¹⁶ 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 L173/84 (hereinafter MiFIR).

Council authorisation, to negotiate with the relevant third country. It also allowed Member States to suspend or restrict investment firms' access to that third country.²¹⁷

During times of crisis, the management of third country entities' access to the EU market increasingly became a function of EU law, as well as a key decision-making area for the ESMA and the EU Commission. Given the complex and divided allocation of regulatory responsibilities between the Commission/ESMA and the Member States, the negotiations to reclaim (or at least partially reclaim) the decision-making authority over market access from the full control of Member States under MiFID I and place it in the hands of the European Commission were inevitably destined for difficult and intense discussions.²¹⁸ Ultimately, the MiFID II third country access regime adopted a dual-track approach, with the allocation of regulatory authority between the European Commission/ESMA and the Member States depending on the manner in which services are provided (through branches or cross-border services) and the type of clients involved (e.g., retail clients or professional clients). This framework determines how access authorisations are distributed between the Commission/ESMA and individual Member States.

Through this compromise approach, the MiFID II/MiFIR framework established a dual-track system²¹⁹ that (largely) preserves the EU Commission's harmonised, European Union-led model for cross-border services, while retaining the Council's light-touch Member State-led model for branches. This system allows for a balance between centralised EU control and individual Member State autonomy regarding market access for third country firms. The pathway for third country investment firms to enter the EU market by establishing a branch and obtaining authorisation from a Member State is outlined in MiFID II. In the meantime, MiFIR provides a framework for third country firms to gain access to the unified EU market without establishing a branch by applying for registration with ESMA. This allows them to 'provide investment services or perform investment activities with or without any ancillary service' to eligible counterparties and professional

²¹⁷ Article 15MiFID I. The restrictions on third-country investment firms are limited to the establishment of branches and the provision of cross-border services; the establishment of subsidiaries is not subject to these restrictions.

²¹⁸ Niamh Moloney, *EU Securities and Financial Markets Regulation* (ch IV.10 3rd edn, Oxford University Press 2014).

²¹⁹ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, Oxford University Press 2014) 404.

clients within the European Union. This creates an European Union-level access route for third country firms under MiFIR.²²⁰

According to MiFID II Article 4(1)(57), a 'third country firm' refers to a firm that would qualify as a credit institution providing investment services, performing investment activities or as an investment firm if its head office or registered office were located within the European Union. It is important to clarify this concept in advance, as the term 'third country firm' could easily be misunderstood by readers who do not have prior background knowledge. Further elaboration is necessary to ensure a clear understanding of the regulatory context and the specific characteristics of these firms under the MiFID II framework:

In certain cases, a company may have a head office or registered office within the European Union, but its legal domicile is outside the European Union. Based on this, a company with its legal domicile in a non-EU country would still be classified as a third country firm, even if it operates within the European Union. In summary, the core definition of a 'third country firm' under MiFID II is that the company's legal domicile is outside the European Union, even if it has branches or operations within the European Union. This distinction allows such companies to be classified as third country firms and subject to the corresponding regulatory requirements.

3.3.1.1 Branch Access Approach

If a third country firm wishes to provide investment services to retail clients and non-professional clients, it typically needs to establish a branch in an EU Member State in accordance with the requirements set by the national competent authority (hereinafter NCA) of that Member State. Once the branch is established, the firm can also offer investment services to professional clients who have 'opted in' to professional status,²²¹ thereby meeting the criteria for professional classification.

Markets in Financial Instruments Directive II, in Articles 39–43, specifically outlines the branch access approach, requiring Member States to grant authorisation to third country branches in compliance with the harmonised regulatory standards established under the

²²⁰ Article 47 MiFIR.

²²¹ Annex II s 2 MiFID II.

MiFID II framework.²²² At the same time, MiFID II also establishes a series of additional regulatory co-operation requirements that third country firms must comply with, such as that the services for which the firm applies for authorisation must be subject to authorisation and regulation in the third country where the firm is established; anti-money laundering, anti-terrorism, and tax arrangements; bilateral co-operation arrangements for the exchange of information between the competent authorities of the Member State and the third country regulatory authority, aimed at maintaining market integrity and protecting investors; and information disclosure obligations of third country firms.²²³

Branch authorisation applications are managed at the Member State level,²²⁴ with the decision on whether to grant authorisation and the conditions for doing so being primarily in the hands of the Member States and not contingent on a European Commission equivalence decision. Although the branch access approach is also subject to a limited number of harmonised conditions, these harmonised conditions are mainly intended to ensure alignment with other EU regulatory frameworks (e.g., 2012 EMIR, 2011 AIFMD and the rating agency regime) and to ensure that third country branches do not receive more favourable treatment than EU firms as a result of Member State access authorisations.²²⁵

Thus, under the Member State-controlled branch access approach, there is only a minimal level of coordination within the European Union, established through the Directive. There is no provision for ESMA registration or further clarification via ESMA-recommended BTS. The European Commission plays no role in determining whether authorisation should be granted. Market access is restricted to the Member State concerned. Additionally, it is worth noting that entities accessing the market of an EU Member State based on the branch access approach do not enjoy passporting rights. When a third country investment firm needs to provide cross-border services within the EU jurisdiction, it must establish a new branch in each individual Member State involved, and be subject to separate authorisation and supervision by the respective NCAs of those Member States. This differs from the European Commission equivalence access approach, where investment services

²²² Article 41 MiFID II.

²²³ Article 39 MiFID II.

²²⁴ Article 39(3) MiFID II.

²²⁵ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, Oxford University Press 2014) 405.

to professional clients are provided through ESMA's registration system for entry into the European Union.

3.3.1.2 Commission equivalence: The European Securities and Markets Authority Registration Approach

In its Title VIII part, MiFR specifically sets out the access routes and regulatory requirements for third country firms that can provide investment services within the European Union without the need to establish a branch, based on a European Commission equivalence decision. However, firms accessing the EU market via ESMA registration are only permitted to provide services to eligible counterparties and per se professional clients; access to the retail market is not allowed under this framework.

Article 47 stipulates that when the European Commission makes an equivalence decision, it must review the regulatory framework of the third country to determine whether it achieves outcomes that are substantively equivalent to those under MiFIR. The review focuses on key areas such as authorisation, supervision and enforcement; capital requirements; governance; organisational requirements; conduct of business rules; and market transparency and integrity requirements,²²⁶ effectively 'exporting' much of the content of MiFID II.²²⁷ In addition to regulatory equivalence, as seen in other financial sectors, the equivalence framework established under MiFIR includes a reciprocity requirement. This means that third countries must also provide an equivalent regime in their domestic legal system, allowing investment services from other countries to access their domestic market under similar equivalent conditions.

Moreover, when applying the equivalence regime to investment services offered by third countries, the European Commission is expected to give priority to areas covered by G20 commitments and agreements with the European Union's major trading partners. In conducting such assessments, the Commission should also take into account the Objectives

²²⁶ Article 47(1) MiFIR.

²²⁷ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, Oxford University Press 2014) 406.

and Principles of Securities Regulation issued by IOSCO, as well as the recommendations as revised and interpreted by IOSCO over time.²²⁸

Article 46(2) requires that third country firms accessing the European Union through the ESMA equivalence decision approach must ensure that their investment service activities are under effective supervision and enforcement, guaranteeing full compliance with the regulatory requirements applicable in their home country. At the same time, MiFIR Article 47 outlines ESMA's role and supervisory authority. The ESMA is required to establish co-operation arrangements with the relevant competent authorities of third countries recognised as equivalent. These arrangements must cover: (1) mechanisms for information exchange between ESMA and the third country authorities concerned, ensuring ESMA's access to all information related to registered third country firms, and the obligation to promptly notify ESMA in case of regulatory breaches by these firms; (2) coordination of supervisory activities between ESMA and the third country authorities, and the retention of ESMA's authority to conduct on-site inspections in appropriate cases.²²⁹

Once a third country is granted an equivalence recognition decision, companies from that country can obtain rights similar to passporting after registering with ESMA (with the registration process governed by the BTS). This allows them to provide investment services directly to the European Union's Single Market, with services crossing Member State jurisdictions without the need to seek separate authorisation from each Member State where the investment services are offered. Member states are not permitted to impose additional requirements on third country firms beyond those set out in the 2014 MiFID II/MiFIR framework, nor are they allowed to grant these firms more favourable treatment than that given to EU firms.²³⁰ If a third country firm establishes a branch in a Member State, the NCA of the Member State (seen as home country in the EU jurisdiction) where the branch is located remains responsible for supervising the branch. The third country NCA should co-operate with the EU home country NCA to oversee the activities of the third country firm jointly.

²²⁸ Niamh Moloney, 'Capital Markets Union, Third Countries, and Equivalence Law, Markets, and Brexit' in *Capital Markets Union in Europe* (Danny Busch, Emiliios Avgouleas and Guido Ferrarini (eds) (1st edn Oxford University Press 2018) 110.

²²⁹ Article 47(2) MiFIR.

²³⁰ Article 46(3) MiFIR.

Third country firms must inform their clients that they are only allowed to provide services to eligible counterparties and professional clients, and that they are not subject to EU regulation.²³¹ Article 49 of MiFIR also sets out the conditions under which ESMA can revoke the registration of a third country firm.

In summary, the requirements for accessing the EU Single Market through the equivalence regime under MiFIR can be outlined as follows²³²: (1) The European Commission declares the third country of the firm as an equivalent country under MiFIR Article 47(1); (2) The third country firm is authorised in its home jurisdiction to provide investment services or carry out investment activities in the European Union and is subject to effective supervision and enforcement, ensuring full compliance with the applicable requirements of that third country; and (3) Co-operation arrangements between ESMA and the relevant third country competent authorities are established in accordance with MiFIR Article 47(2).

The 2019 IFR²³³ introduced reforms to MiFID II/MiFIR, imposing stricter conditions on when third country investment firms are granted equal treatment for providing cross-border services under the reformed EU investment services framework.

The most notable change is the introduction of risk-based conditions. According to the 2019 IFR, when making an equivalence decision, the European Commission must consider the potential risks that third country firms may pose when providing services or conducting activities in the European Union after the decision is made.²³⁴ Article 47 of MiFIR was amended to stipulate that if the scale and scope of the investment services or activities provided by a third country firm could be systemically important to the European Union, equivalence could only be granted following a 'detailed and thorough assessment' of the third country rules by the European Commission.²³⁵ The systemic importance of a third country firm should be assessed based on criteria such as the potential scale and scope of the services and activities provided by the firm.²³⁶ Additionally, jurisdictions that are non-

²³¹ Article 46(4) MiFIR.

²³² ESMA, Final Report Draft Technical Standards on the Provision of Investment Services and Activities in the Union by Third-Country Firms Under MiFID II and MiFIR, 28 September 2020, ESMA 35-43-2424.

²³³ Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms [2019] OJ L 314/1 (IFR)

²³⁴ Recital 45, IFR.

²³⁵ MiFIR, art 47(1), as amended by IFR, art 63.

²³⁶ Recital 45, IFR.

co-operative for tax purposes are also cross-referenced as part of the risk assessment criteria, along with Article 9(2) of 4th Anti-Money Laundering Directive,²³⁷ and serve as benchmarks for identifying high-risk third countries.²³⁸

For third country firms with systemic importance, the European Commission has the authority to attach 'specific operational conditions' to any equivalence decision. This is to ensure that ESMA and national regulatory authorities have the necessary tools to prevent regulatory arbitrage. It also enables monitoring of such firms' activities by ensuring their compliance with requirements that have equivalent effects to specific MiFIR obligations, such as the MiFIR Share Trading Obligation (hereinafter STOs) and derivatives trading obligations (hereinafter DTOs), post-trade transparency reporting, and transaction reporting requirements.²³⁹ In practice, these specific obligations directly apply to the relevant third country investment firms through the conditions attached to the equivalence decision. Regarding the equivalence assessment criteria, the IFR Reform also shifted attention towards regulatory convergence between the European Union and third countries in terms of prudential, organisational and business conduct frameworks.²⁴⁰

The IFR also strengthened ESMA's authority in the area of investment services access. As a new regulatory instrument, the 2019 IFR introduced additional subparagraphs directly under Article 46 of MiFIR, thereby granting ESMA enhanced powers and expanded information requirements:

First, under MiFIR Article 46(7) amended by IFR, ESMA is empowered to draft RTSs specifying the information that third country firms must provide when applying for registration under MiFIR Article 46(4). In response to this mandate, the European Commission adopted Delegated Regulation No. 2016/2022 (the 'existing Article 46 RTS'), which outlines the list of information that third country firms must submit to ESMA during the registration process. The IFR also grants ESMA the authority to require third country firms registered in ESMA's registry to provide data related to all orders and all transactions conducted within the European Union, whether on their own account or on behalf of

²³⁷ European Parliament and Council, European Parliament and Council Directive (EU) 2015/849 of 20 May 2015 on the Prevention of the Use of the Financial System for the Purposes of Money Laundering or Terrorist Financing [2015] OJ L141/73.

²³⁸ Recital 45, IFR.

²³⁹ MiFIR, art 47(1a)(a)-(c), as amended by IFR, art 63(5)..

²⁴⁰ Article 63 (5)(a)(1b), IFR.

clients, for a period of five years.²⁴¹ In addition, enhanced reporting requirements now apply to third country investment firms registered with ESMA. These firms must report annually to ESMA on the scale and scope of the services they provide and the activities they conduct within the European Union. Supervisory co-operation related to monitoring, enforcement and ensuring the fulfilment of equivalence conditions should also be improved.²⁴²

The IFR Reform also expanded ESMA's powers of onshore supervision of third country investment firms registered with it. While the MiFIR regime does not require ESMA to conduct onshore supervision of third country firms, ESMA has been granted specific supervisory powers to oversee these firms: ESMA can conduct investigations and on-site inspections of registered firms and can, in specified circumstances (including where a firm does not comply with an information request or co-operate with an investigation or on-site inspection) temporarily prohibit or restrict a firm's activities. In the special circumstances outlined in MiFIR Article 46, ESMA has the authority to intervene directly and temporarily prohibit or restrict a third country firm from providing investment services or conducting investment activities within the European Union.

Branches of third country firms authorised under MiFID II Article 39 remain fully supervised by the competent authority of the Member State where they obtained authorisation. However, under Article 41(2) of MiFID II, as mandated by the Investment Firms Directive (hereinafter IFD)²⁴³, ESMA is required to publish an annual list of third country firm branches active in the European Union based on information collected from national competent authorities.

3.3.2 Trading Venues

The goal of MiFID II/MiFIR is to enhance the transparency of equity instruments significantly by bringing more trading into multilateral trading venues, such as RMs and

²⁴¹ Article 46(6b) MiFIR.

²⁴² Recital 43, IFR.

²⁴³ European Parliament and of the Council, Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the Prudential Supervision of Investment Firms and Amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU.

MTFs.²⁴⁴ This aims to improve price formation and investor protection. The fully developed equity market structure shaped by the regulatory framework of MiFID II/MiFIR will also be a prerequisite for the success of the Capital Markets Union (hereinafter CMU).²⁴⁵

The regime for trading venues is dispersed across the 2014 MiFID II Directive and the 2014 MiFIR Regulation. MiFID II broadly covers the authorisational, organisational and operational requirements applicable to trading venues, while MiFIR extensively addresses transparency regimes and transaction reporting, specifies particular venues for equity trading, and establishes different venue classifications. A dense manual of administrative rules supplements these provisions, making the legislative framework more comprehensive. The MiFID II/MiFIR reforms fundamentally reshaped the MiFID I system and significantly expanded and strengthened the European Union's intervention on trading venues.

The era of crises led to more stability-oriented, interventionist regulation of trading venues, bringing bond and derivatives trading venues, whether organised/multilateral or bilateral/over-the-counter, under regulatory oversight. Under the MiFID II and MiFIR regulatory framework, the concept of trading venues has been refined into different types of market structures, thereby creating a multi-tiered system of trading venues, including RMs, MTFs and OTFs.

Regulated Markets are the most formal and highly regulated trading venues, typically operated by exchanges such as the London Stock Exchange (hereinafter LES) and Euronext. They are subject to strict scrutiny and ongoing supervision by the regulatory

²⁴⁴ To achieve this goal, the legislation prohibits broker-crossing networks (through the share trading obligation) and restricts dark pool trading (through the volume cap mechanism. In the 2024 MiFID II/MiFIR amendments, the previous double volume cap mechanism (4% and 8%) were replaced with a single volume cap. The new cap sets a 7% limit on the volume of trading executed under the reference price waiver or the negotiated trade waiver. Given that the research topic of this thesis is the equivalence regime, the regulation of dark pools and the volume cap mechanism falls outside the scope of this study. Therefore, this section will not cover those topics, focusing instead on the Share Trading Obligation (STO).

²⁴⁵ National Securities Market Commission (CNMV) Advisory Committee, Response to ESMA Consultation on MiFID II/MiFIR Review Report on the Transparency Regime for Equity and Equity-Like Instruments, the Double Volume Cap Mechanism and the Trading Obligations for Shares (Spanish National Securities Market Commission, 2020) <https://www.cnmv.es/DocPortal/AIDia/ESMA_MiFIDII_MiFIR.pdf?>

authorities of EU Member States, with the most stringent regulatory requirements.²⁴⁶ In the prospectus regime, 'regulated markets' serve as a form of boundary control, delineating the line between regulated public markets and typically less regulated private markets. Under the Prospectus Regulation, regulated markets are considered synonymous with large, public and highly liquid trading venues.

Multilateral Trading Facilities are more flexible trading platforms that allow multiple third parties (i.e., buyers and sellers) to trade financial instruments. The arrangements for trading are organised by the platform operator, which is typically a financial firm or exchange, and the bids and offers of market participants are publicly visible.²⁴⁷

Organised Trading Facilities are a new type of trading venue introduced under MiFID II, specifically designed for the trading of non-equity financial instruments such as bonds, structured finance products, emission allowances and derivatives. These facilities also allow for the inclusion of some OTC trades, aiming to shift OTC trading towards more transparent trading platforms, which is one of the regulatory objectives of MiFID II.²⁴⁸

In terms of regulatory intensity, RMs are subject to the most stringent oversight, followed by MTFs and then OTFs. Regulated Markets constitute the most official and highly regulated form of trading venue, characterised by the highest level of transparency and the most comprehensive set of regulatory requirements. As such, they form the foundation of the financial market infrastructure.

The key distinction between MTFs and OTFs lies in the degree of discretion permitted in the execution of orders. MTFs operate on a non-discretionary basis, meaning that once an order enters the system, it is matched automatically and strictly according to pre-established rules. The operator has no ability to influence the execution of orders or to determine which counterparties are matched. This mechanism closely resembles the automatic matching systems employed by traditional exchanges.

In contrast, OTFs permit a degree of *discretionary execution*, allowing the operator to exercise judgement over how and when client orders are executed, and how they are

²⁴⁶ Article 4(1)(21) of MiFID II.

²⁴⁷ Article 4(1)(22) of MiFID II.

²⁴⁸ Article 4(1)(23) of MiFID II.

matched with counterparties, provided that such discretion is exercised in accordance with best execution and other regulatory obligations. This flexibility makes OTFs particularly suitable for trading complex, illiquid or bespoke financial instruments.

It follows that OTFs are generally more flexible than MTFs and bear closer resemblance to the traditional OTC trading model. While OTFs are still subject to transparency obligations under MiFIR, the nature of the instruments traded – often illiquid or bespoke – means that the regulation permits *waivers* and *deferrals*, particularly in relation to pre-trade transparency.²⁴⁹ In this sense, the OTF can be seen as a '*tamed*' OTC platform: it retains certain core characteristics of OTC trading, such as non-automated execution and operator intervention, yet is now required to function within a more regulated and transparent framework. This reflects the post-crisis regulatory agenda aimed at bringing previously opaque market segments under formal oversight.

For derivative contracts, trading on an MTF or OTF is still classified as *OTC*, despite the fact that such trading has become significantly more standardised compared to the pre-global financial crisis period. The continued classification of MTF- and OTF-traded derivatives as OTC instruments highlights the *off-exchange nature* of these venues, clearly distinguishing them from the highly regulated and centralised environment of *regulated markets*.

The establishment of a multi-tiered system of trading venues and the delineation of their respective boundaries form the foundational infrastructure that MiFID II/MiFIR provides for the trading of financial instruments. Concepts such as the DTO and STO must be discussed with an understanding of the composition of trading venues as a background concept.

3.3.3 Equivalence Regime in Derivatives Trading Obligation

As part of the financial reform agenda prompted by the 2008 global financial crisis, the 2009 G20 Pittsburgh Summit made the commitment to ensure that, by the end of 2012, all 'standardised OTC derivative contracts' would be traded on exchanges or 'electronic trading

²⁴⁹ Article 9 of MiFIR explicitly provides for Pre-Trade Transparency Waivers For Non-Equity Instruments, Whereas Article 11 Allows For Post-Trade Transparency Deferrals under certain conditions. These mechanisms are designed to protect market liquidity, as mandatory pre-trade disclosure for highly illiquid instruments may hinder rather than facilitate trading.

platforms' and cleared through central clearing systems²⁵⁰. As response, the EU introduced the Derivatives Trading Obligation (DTO) under MiFIR, which mandates that certain categories of OTC derivatives must be traded on European Union-regulated markets, MTFs, OTFs or third country trading venues recognised as equivalent.²⁵¹ For cross-border transactions, if a third country derivatives trading venue has not been granted equivalence recognition, EU financial institutions will be unable to trade derivatives on that venue.

The DTO introduced by MiFIR primarily applies to EU financial counterparties (FCs) and non-financial counterparties (NFCs). These companies typically include large enterprises that engage in significant derivatives trading, such as energy companies and manufacturing firms, which use derivatives to hedge business risks. If an FC or NFC has a registered office in a EU Member State, it is considered an 'EU counterparty' and is therefore subject to the DTO under MiFIR. At the same time, MiFID II and MiFIR allow third country firms to provide investment services within the European Union through branches. If these branches meet certain conditions, they are also considered 'EU counterparties' and, as a result, become subject to the DTO. If a third country firm conducts a transaction with an EU financial institution or non-financial counterparty, even if the third country firm is not located within the European Union, the transaction may still be subject to the DTO as long as it has a direct, substantial and foreseeable effect within the Union.²⁵²

Similar to the process for determining which types of derivative are subject to the 2012 EMIR clearing obligation, the key decision regarding which categories of derivatives are subject to the DTO is also made by ESMA.

3.3.3.1 Scope Determination of the Derivatives Trading Obligation

The DTO does not apply to all derivatives but is subject to clearly defined eligibility criteria. The ESMA plays a central role in determining which derivative classes fall within the scope of the DTO. To this end, it applies three core criteria: (a) being subject to the EMIR clearing obligation; (b) being admitted to trading or traded on at least one European

²⁵⁰ Group of Twenty (G20) Pittsburgh Summit, 'Leaders' Statement, Strengthening the International Financial Regulatory System,' Pittsburgh 24–25 September 2009.

²⁵¹ Article 28 MiFIR.

²⁵² Article 28(2) MiFIR.

Union trading venue; and (c) having sufficient liquidity²⁵³. In addition, ESMA lists the derivative classes subject to the DTO in the *Public Register for the Trading Obligation for Derivatives* under MiFIR.²⁵⁴ This register specifies the exact types of derivatives that fall within the scope of the DTO. From the *Public Register*, it is evident that the scope of the DTO is relatively narrow.

This limited application can be explained by several factors: First, the DTO applies only to a subset of the derivatives already subject to the EMIR clearing obligation. This means that OTC derivatives that are not mandated for central clearing, particularly those that are non-standardised or exhibit low liquidity, are excluded from the outset. Second, only derivatives deemed by ESMA to have 'sufficient liquidity' are brought within the scope of the DTO. This liquidity threshold is a stringent filter, excluding a large number of instruments that are traded infrequently or in low volumes. Third, the DTO primarily targets highly standardised derivatives. Customised or structurally complex contracts, which are more difficult to trade in regulated venues and do not lend themselves easily to transparency and uniform trading protocols, are generally not covered by the obligation.

Reports and analyses published by industry peers also confirm the limited scope of the DTO. For example, a 2022 report by ISDA noted the following: 'The report states that the total interest rate derivatives [IRD] notional traded on trading venues (hereinafter TVs) was more than double the notional of IRD transactions subject to the DTO.'²⁵⁵ This indirectly confirms that the volume of transactions subject to the DTO is significantly lower than the total volume of trades executed on trading venues. In another report,²⁵⁶ ISDA noted that although the notional amount of IRDs traded on EU trading venues is substantial: 'IRD traded notional executed on TVs in the European Union far exceeded (by 56.0%, or \$3.5 trillion) the IRD traded notional subject to the trading obligation.' This indicates that the DTO covers only a small portion (approximately 44%) of IRDs traded on venues, not to mention the vast segment of the market that remains over-the-counter.

²⁵³ Article 32 MiFIR.

²⁵⁴ ESMA, *Public Register for the Clearing Obligation under EMIR* (ESMA, 2024) <https://www.esma.europa.eu/sites/default/files/library/public_register_for_the_clearing_obligation_under_emir.pdf> accessed 14 October 2024>

²⁵⁵ International Swaps and Derivatives Association (ISDA). *ISDA Responds to ESMA on Clearing and Derivative Trading Obligations in View of 2022 Benchmark Transition Status* 30 September 2022, <<https://www.isda.org/2022/09/30/isda-responds-to-esma-on-clearing-and-derivative-trading-obligations-in-view-of-2022-benchmark-transition-status/>>

²⁵⁶ International Swaps and Derivatives Association (ISDA). 'Demystifying Derivatives Trading in the EU', (2022) <<https://www.isda.org/a/zAWgE/Demystifying-Derivatives-Trading-in-the-EU.pdf>>

3.3.3.2 Slow Progress in Derivatives Trading Obligation Equivalence Determinations

Compared to the pace of third country CCP equivalence under EMIR, progress on equivalence determinations for trading venues under the DTO framework has been noticeably slower. It is worth noting that the European Commission grants equivalence to third country trading venues under the DTO through a formal Implementing Decision. Once such a decision is adopted, the recognised venues are deemed equivalent to EU trading venues for the purposes of the trading obligation. Importantly, these venues are not required to undergo any additional registration or authorisation process with ESMA. According to formal decisions taken by the European Commission, only the United States and Singapore have thus far been granted equivalence for trading venues in relation to the DTO. Specifically, the European Union has recognised certain Swap Execution Facilities (hereinafter SEFs) and Designated Contract Markets (hereinafter DCMs) regulated by the US CFTC as equivalent trading venues, but only for specific classes of derivatives.²⁵⁷ Similarly, trading venues regulated by the Monetary Authority of Singapore (hereinafter MAS) have been granted equivalence, although, again, the recognition is limited to a narrow range of derivative products.²⁵⁸

The European Union's DTO applies exclusively to highly liquid, standardised derivatives that are already subject to the clearing obligation under EMIR, such as a limited number of IRSs and CDS indices. The trading volume of these products is concentrated in a small number of venues, notably in specific third countries such as the United Kingdom (e.g., the LSE and the ICE),²⁵⁹ and their overall share in the broader derivatives market is relatively modest. As a result, the absence of equivalence recognition may not have a significant

²⁵⁷ European Commission Implementing Decision (EU) 2021/85 of 27 January 2021 on the equivalence of the United States legal and supervisory framework applicable to central counterparties (CCPs) in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council [2021] OJ L29/6.

²⁵⁸ Commission Implementing Decision (EU) 2021/110 of 27 January 2021 on the equivalence of the legal and supervisory framework applicable to central counterparties (CCPs) in the United Kingdom of Great Britain and Northern Ireland in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council [2021] OJ L34/25.

²⁵⁹ For example, the Financial Conduct Authority (FCA), in its policy statement on the inclusion of SOFR OIS (Secured Overnight Financing Rate Overnight Index Swaps) in the Derivatives Trading Obligation (DTO) (PS25/2), stated

The ability of UK firms subject to the DTO to discharge their obligation on US venues – the market with most of the liquidity for SOFR – means that UK firms will continue to have access to the deepest pool of liquidity once our determination is in force

This statement implies that liquidity for certain products is concentrated globally, including in the United Kingdom and the United States.

impact on many third country trading venues. Conversely, the European Union also lack incentive to expand the scope of equivalence determinations under the DTO, given the narrow market segment it targets and the concentration of trading activity in just a few platforms.

Following Brexit, UK trading venues such as ICE Futures Europe and LSE no longer benefit from automatic equivalence within the European Union. Despite their central role in derivatives trading for EU CCPs, the European Commission has so far refrained from granting equivalence to UK venues under the DTO framework. This hesitation is driven by concerns that EU market participants may continue to outsource trading activities to London, thereby undermining the European Union's strategy of market integration and weakening the objectives of the CMU. More broadly, the European Union has sought to reduce its reliance on UK financial services, enhance its financial autonomy and to safeguard the stability of the Single Market.

Against this backdrop, the equivalence decisions granted to trading venues in the United States and Singapore under the DTO regime appear more symbolic than substantive. Both decisions were issued in January 2021 immediately after the United Kingdom's formal departure from the European Union, suggesting an intent to demonstrate the European Union's commitment to a non-discriminatory approach to third country regulation. At the same time, equivalence for US and Singaporean venues was necessary to prevent abrupt disruptions in transatlantic and Asia-Pacific derivatives trading, given the global significance of these markets. However, these decisions were deliberately cautious and narrowly framed, reflecting the European Union's broader concern about liquidity outflows and its desire to retain control over core market infrastructure in support of financial sovereignty.

3.3.4 Equivalence Regime in Share Trading Obligation

The European Union's STO is a provision embedded with equivalence in MiFIR. The original wording of Article 23(1) of MiFIR defines the STO as follows²⁶⁰:

²⁶⁰ Article 23(1) MiFIR.

An investment firm shall ensure that the trades it undertakes in shares admitted to trading on a regulated market or traded on a trading venue shall take place on a regulated market, an MTF, a systematic internalizer or a third country trading venue assessed as equivalent in accordance with Article 25(4)(a) of Directive 2014/65/EU.

The provision identifies the scope of the STO as applying to shares 'admitted to trading on a regulated market' or 'traded on a trading venue'. At first glance, this appears to suggest that any share listed or effectively traded on any EU trading venue would fall within the scope of Article 23(1). Consequently, any transaction in such shares by an EU investment firm would be subject to the STO. However, this broad formulation gives rise to considerable ambiguity in practice and potentially results in an overly expansive application of the obligation, capturing shares with only nominal or secondary listings within the European Union.

Theoretically, if a share has been traded even once on an EU MTF, it may be considered 'traded on a trading venue' and thus fall within the scope of the STO. This imposes a significant compliance burden and risks market fragmentation, particularly for globally traded stocks whose primary liquidity lies outside the European Union but are occasionally traded within it. Moreover, many shares may be listed or admitted to trading on multiple EU-regulated markets, while their main trading activity and liquidity remain concentrated elsewhere; for instance, in the case of dual listings in London and Frankfurt where the bulk of trading occurs in London. A strict application of the criterion 'admitted to trading on a regulated market' would still trigger the STO, thereby effectively forcing trading back into the European Union, even when the EU venue is not the most suitable place for best execution. Finally, the provision lacks a clear identification standard for shares subject to the STO. National competent authorities are thus required to make complex determinations about what constitutes 'traded on a trading venue' or 'admitted to trading,' leading to considerable uncertainty and interpretive divergence.

The EU STO has a significant impact on stocks that are dual-listed in both third countries and within the European Union, particularly when it comes to the issue of equivalence recognition for third country markets.

Since the STO primarily applies to EU investment firms, rather than the stocks themselves, it regulates where EU investment firms must execute trades rather than directly restricting the trading of third country stocks. In other words, the STO mandates that EU investment firms must choose compliant trading venues when conducting equity transactions, but it does not directly limit the trading of third country stocks. Therefore, the STO focuses on who is trading (i.e., EU investment firms), rather than what is being traded (i.e., specific stocks).

If a third country stock is only listed on a third country market and not on an European Union-regulated market, such stocks fall outside the scope of the STO. This means EU investment firms are free to choose whether to trade on that third country market without being constrained by the STO. Conversely, if the third country stock is dual-listed on both a third country market and a European Union-regulated market, EU investment firms must comply with the STO. In this case, EU investment firms can only trade on European Union-recognised trading venues unless the third country market has been granted equivalence by the European Commission. If the third country trading venue has not been granted equivalence, EU investment firms are prohibited from trading on that third country market, even if the stock is listed there. This reduces the liquidity of that stock on the third country market, leading to a fragmentation of liquidity between the European Union and third country markets. As a result, this liquidity split can cause discrepancies in market prices between the two markets. In the post-Brexit landscape, the fragmentation risk has been heightened, as trading venues in the United Kingdom are now treated as third country venues under EU law, potentially splitting liquidity between the United Kingdom and the European Union, especially for shares listed in both regions.²⁶¹

For dual-listed stocks, because EU brokers may need to access two liquidity pools, the STO restrictions on accessing such liquidity could discourage dual-listed issuers from maintaining their EU listing. This could lead issuers to delist from the European Union in order to avoid the constraints of the STO, especially when the primary liquidity for the stock is outside the European Union.²⁶² Worse still, the original STO framework under MiFID II/MiFIR did not provide exemptions for illiquid shares. This meant that even

²⁶¹ ESMA, 'Public Statement Brexit: Impact of the End of the Transition Period on 31 December 2020 on the Trading Obligation for Shares' (Article 23 of MiFIR), 26 October 2020, ESMA70-155-7782.

²⁶² Euronext, 'MiFID Refit: Euronext Position on Scope of Share Trading Obligation' Response to ESMA Consultation, Memorandum 2021).

where a third country share enjoyed high liquidity on non-EU markets but remained illiquid within the European Union, EU investment firms were nonetheless required to trade such shares on EU trading venues. As a result, EU firms were effectively prevented from accessing more liquid third country markets for trading third country shares, thereby severely restricting market access and execution quality.²⁶³

Additionally, under the original rules, if equivalence is not granted, non-EU stocks that are also authorised for trading in the European Union must be traded by EU investment firms within the European Union, even if they are traded on non-equivalent third country venues.²⁶⁴ Such as the China–Europe Depositary Receipt (hereinafter CEDR), which is a depositary receipt mechanism between China and the European Union, aimed at allowing Chinese companies to issue depositary receipts in European markets, or for EU companies to issue depositary receipts in Chinese markets. This raises further concerns about extraterritoriality, as it imposes EU regulatory requirements on trading activities that may primarily occur outside the European Union.

To address the aforementioned ambiguities and operational challenges, ESMA gradually introduced the ISIN code as a key criterion for determining the scope of the STO through its reports and Q&As shortly after the entry into force of MiFID II/MiFIR. ESMA proposed the following reform:

First, the presence of an EU International Securities Identification Number (hereinafter ISIN) serves as an initial indicator of whether a share is subject to the STO. For stocks with an EU ISIN, trading should be allowed on third country trading venues in the local currency of the third country without being subject to the STO restrictions. This would allow EU market participants to access additional liquidity pools, while limiting any unfair competition with EU trading venues. Transactions in the local currency are typically aimed at domestic investors in the third country involved, who may not have access to EU trading venues. Meanwhile, EU investors would generally continue to trade EU stocks in the issuer's home currency.²⁶⁵

²⁶³ *ibid.*

²⁶⁴ *ibid.*

²⁶⁵ ESMA, MiFID II/MiFIR Review Report on the Transparency Regime for Equity and Equity-like Instruments, the Double Volume Cap Mechanism and the Trading Obligations for Shares, No. 236.

Second, ESMA incorporated liquidity as a determining factor in the scope of the STO. It believes that allowing trading on third country venues in the local currency does not pose significant regulatory arbitrage risks.²⁶⁶ This is because trading in a third country currency introduces additional currency risks for investment firms, which offsets the potential profitability of cross-border regulatory arbitrage. Therefore, allowing trading on third country venues in the local currency (even if those venues have not been granted equivalence) as an exemption to the STO²⁶⁷ would not introduce financial risks. At the same time, it ensures that EU investment firms can fully leverage the liquidity of stocks traded on regulated venues.

Regarding the challenges posed by Brexit to the STO, before the STO exemption provisions under MiFIR were amended. The ESMA utilised the exemption from the 2014 MiFIR. This allowed UK trading venues to be exempt from the STO, enabling EU investment firms to continue trading stocks on UK trading venues. In October 2020, ESMA issued a Public Statement²⁶⁸ allowing EU investment firms, under very limited circumstances, to be exempted from the EU STO with respect to a small subset of European Economic Area (EEA) ISIN shares denominated in British pound sterling (hereinafter GBP) and traded in the United Kingdom. The ESMA considered that such transactions were generally 'non-systematic, ad hoc, irregular, and infrequent,'²⁶⁹ and therefore qualified for the exemption provided under the 2018 MiFIR framework. However, the scope of this exemption was extremely narrow. It did not apply to EEA ISIN shares denominated in euros or other EU currencies, nor did it extend to most EU shares traded on UK venues such as the LSE.

Recently, the European Parliament and the Council of the European Union adopted the 2024 MiFIR amendment, introducing modifications to the STO in line with recommendations made in ESMA's review report. The revised framework confirms the use of the EU ISIN as a preliminary indicator for determining whether a share falls within the scope of the STO. Furthermore, it refines the exemption criteria for shares with an EU ISIN. Specifically, it replaces the earlier non-systematic, ad hoc, irregular and infrequent

²⁶⁶ *ibid*, No. 237.

²⁶⁷ *ibid*, No. 238.

²⁶⁸ ESMA, 'Public Statement Brexit: Impact of the End of the Transition Period on 31 December 2020 on the Trading Obligation for Shares' (Art 23 of MiFIR), 26 October 2020, ESMA70-155-7782.

²⁶⁹ European Parliament and Council, 'Regulation (EU) No. 600/2014 on Markets in Financial Instruments (MiFIR), Art 23 (1)(a), as It Stood Before the 2024 Amendment' (12 June 2014) Official Journal of the European Union L 173/84.

exemption standard with a new condition: the shares must be traded on a third country venue in the local currency or in a non-EEA currency. Such transactions are more likely to be locally driven and thus less relevant to the objectives of the EU STO, allowing the regime to focus more precisely on trades with a direct connection to EU market liquidity.²⁷⁰ In addition, the amendment introduces an exemption for trades between eligible counterparties or professional counterparties, where such transactions do not contribute to the price discovery process.

The amended MiFIR article 23 would further empower ESMA to publish a list on its website containing the shares with an ISIN subject to the share-trading obligation; ESMA would be required to update that list regularly.²⁷¹

3.3.4.1 Limited Practical Application of the Share Trading Obligation Equivalence

Unlike the DTO, which has a relatively narrow scope, the STO applies to a much broader set of financial instruments, namely equities. Yet despite its broad reach, the equivalence regime for the STO has seen limited implementation. This is due to several reasons:

First, the European Union aims to maintain direct regulatory oversight over all shares issued under an EU ISIN, as well as those with a strong nexus to EU markets. The recent amendments to the STO framework clearly reflect the European Union's intention to concentrate the trading of 'EU shares' (i.e., shares with an ISIN corresponding to an EU Member State) on European Union-regulated trading venues. This objective is closely aligned with the broader CMU agenda, which seeks to dismantle cross-border barriers and integrate the European Union's fragmented capital markets. As equity markets are considered a cornerstone of the CMU, the STO plays a strategic role in this integration effort. By reinforcing the use of EU trading venues, the European Union aims to enhance liquidity and market depth within its internal trading infrastructure; strengthen the price

²⁷⁰ Article 22c, Regulation (EU) 2024/791 of the European Parliament and of the Council of 28 February 2024 amending Regulation (EU) No. 600/2014 as regards enhancing data transparency, removing obstacles to the emergence of consolidated tapes, optimising the trading obligations and prohibiting receiving payment for order flow. (2024 MiFIR Amendment).

²⁷¹ European Parliament, 'Amendments to MiFID II and MiFIR: The EU's Markets in Financial Instruments, Briefing (Members' Research Service, PE 733.546 – April 2024'.

discovery function of EU markets, and ultimately develop a more robust and competitive single equity market within the Union.

If the European Union were to grant widespread equivalence to third country trading venues, a significant volume of trading in EU shares could continue to take place outside the Union: on markets such as London, New York or Hong Kong. This would run directly counter to the European Union's objective of consolidating market liquidity within its internal trading venues, thereby undermining the depth and influence of the European Union's capital markets.

The European Union seeks to ensure full regulatory sovereignty and control over its core financial infrastructure. Given the central role of equity markets in price formation and broader economic functioning, the European Union aims to retain direct supervisory, enforcement and intervention powers over the trading of EU shares. This is essential for preventing market abuse such as insider trading and market manipulation, and for safeguarding market integrity. Granting equivalence to third country venues would entail a significant degree of reliance on the quality and enforcement capacity of non-EU regulators. The European Union has adopted a notably cautious stance toward such reliance, particularly in the strategically sensitive domain of equity markets.

In addition, the European Union is actively advancing the creation of a pan-European Consolidated Tape,²⁷² which aims to aggregate trading data from all EU trading venues. If a significant volume of trading takes place outside the European Union on venues that have not been granted equivalence, such critical data would fall outside the European Union's transparency framework. This would undermine overall market transparency and impair the ability of EU regulatory authorities to monitor market developments and make informed supervisory decisions.

The Brexit process has undoubtedly reinforced the European Union's increasingly control-oriented, rather than deferential, approach to regulating the STO. Prior to Brexit, London

²⁷² European Parliament and of the Council, Regulation (EU) 2024/791 of the European Parliament and of the Council of 28 February 2024 amending Regulations (EU) No. 600/2014 and (EU) 596/2014 as regards enhancing data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders, and Directives 2014/65/EU and (EU) 2023/2223 as regards enhancing data transparency and optimising the trading obligations.

had long served as Europe's primary equity trading hub, with a significant volume of EU ISIN shares traded on UK venues. Following the United Kingdom's departure from the European Union, the European Union refused to grant STO equivalence to UK trading venues such as the LSE, effectively compelling EU investment firms to shift their equity trading back to European Union-based venues such as Euronext Paris and Xetra Frankfurt. This relocation was swiftly confirmed by market data; for example, Amsterdam overtook London as Europe's largest equity trading centre shortly after Brexit.²⁷³ One of the most tangible effects of the MiFIR STO has thus been the repatriation of liquidity in EU shares from London to EU venues. This reflects a strategic post-Brexit move by the European Union to consolidate its financial centre and to prevent further market fragmentation.

The second reason lies in the more precise and pragmatic delineation of the scope of the MiFIR STO. Under the original 2018 MiFIR framework, the ambiguous criteria for determining which shares were subject to the STO led to considerable market confusion and disruptions to liquidity. However, the 2024 MiFIR Amendment has clarified that the STO applies specifically to shares with an EU ISIN, while also introduces an exemption for shares 'traded on a third country venue in the local currency or in a non-EEA currency'. This adjustment mitigates the extraterritorial impact of the trading obligation on third country shares, and reflects a more focused and pragmatic regulatory approach.

In effect, the STO no longer applies to trades in EU ISIN shares on third country venues where the European Union is not the primary centre of liquidity and the trades are not denominated in EU currencies. This allows EU investment firms to continue trading such shares on those foreign venues without being forced to repatriate the activity to the European Union. The 2024 amendment therefore enables the STO to concentrate more narrowly on shares that have a genuine nexus to EU markets, that is, where both the principal liquidity and pricing currency are European Union-based. Such markets are relatively limited globally and hence the need for extensive equivalence determinations is reduced. In line with this approach, the European Union has granted equivalence to jurisdictions such as the United States, where trading infrastructure and regulatory standards meet the required thresholds.

²⁷³ Philip Stafford, 'Amsterdam Ousts London as Europe's Top Share Trading Hub', Financial Times (10 February 2021).

3.4 Conclusion

In this chapter the application of the EU equivalence regime within the frameworks of EMIR and MiFID II/MiFIR was analysed, both of which illustrate how equivalence has become a central instrument for structuring the Union's external financial relations while consolidating regulatory authority at the EU level. Despite their sector-specific features, a consistent dynamic emerges: equivalence functions not merely as a market-access tool, but as a mechanism through which the European Commission centralises supervisory competences, strengthens the Single Rulebook, and elevates the role of ESMA as a technocratic authority.

In the clearing domain governed by EMIR, the starting point was the G20 consensus on strengthening transparency and stability in the derivatives market. This translated into mandatory central clearing, a reporting obligation for all OTC derivatives, and punitive capital charges for contracts that remain uncleared. The ESMA's role in classifying which derivatives fall under the clearing obligation has reinforced its technical authority and extended the European Union's regulatory influence beyond its borders. Within this framework, the recognition of third country CCPs emerged as a crucial element, since CCPs constitute core market infrastructures whose systemic importance requires strict supervision. Equivalence in this field has therefore operated both as a safeguard for EU financial stability and as a channel for shaping international clearing practices.

In the securities and trading domain, the MiFID II/MiFIR framework applied equivalence to investment firms, trading venues, and obligations such as the STO and DTO. Here the Commission introduced a dual-track system: centralised ESMA registration for cross-border services and continued Member State discretion for branches. This arrangement reflects the Commission's determination to retain a harmonised, EU-led model of market access while carefully managing the location of trading activity in line with the CMU. The selective and often cautious application of trading venue equivalence, particularly after Brexit, further demonstrates how equivalence has been used as a strategic tool for balancing openness with financial sovereignty.

Taken together, these developments highlight the circular dynamic between centralisation and the construction of the Single Rulebook. The Commission's assertion of authority

through equivalence has reinforced the Union's regulatory unity, while the Single Rulebook itself has provided the framework for further centralisation. The ESMA has emerged as the indispensable technocratic body exercising daily supervisory powers under this system, giving substance to the Commission's decisions and extending the European Union's market-shaping influence. Equivalence thus offers a revealing stage on which the European Union's regulatory state is visible in action: consolidating competences at the supranational level, elevating technocratic governance, and at the same time aligning the Union more closely with global standards. In this way, equivalence not only manages interdependence but also positions the EU as an active contributor to international regulatory convergence.

The analysis in this chapter has shown how equivalence under EMIR and MiFIR has developed into a powerful instrument of EU financial governance, driving centralisation and reinforcing the Single Rulebook. By contrast, in other areas of EU financial legislation, equivalence has not advanced with the same speed or intensity. Frameworks such as issuer disclosure, funds, insurance and credit rating agencies all contain equivalence provisions, but their implementation has remained limited and progress slow. The next chapter turns to these fields, illustrating how, despite the presence of legislative foundations, the practice of equivalence has so far remained cautious and fragmented.

CHAPTER 4: EQUIVALENCE REGIME IN OTHER FINANCIAL SECTORS

4.1 Introduction

In this chapter equivalence is discussed further with a review of its incorporation into other areas of European Union (hereinafter EU) financial services legislation. Unlike the previous chapter, in which the European Market Infrastructure Regulation (hereinafter EMIR) and the Markets in Financial Instruments Regulation (hereinafter MiFIR) were analysed, the four sectors considered here show limited practical use of equivalence, and follow models that diverge significantly from those found in clearing and trading. The analysis proceeds sequentially through share issuance and disclosure (i.e., the Prospectus Regulation, Transparency Directive and the accounting and financial reporting framework), credit rating agencies, the fund industry and the insurance sector. Taken together with the preceding chapter, this discussion provides a more detailed understanding of how equivalence has been embedded across the European Union's legal framework, offering the necessary background to grasp the basic architecture and functioning of the regime.

The chapter is concluded with a hypothesis that was formulated by drawing on legislative texts and practical experience, namely that in financial sectors closely tied to retail markets, the interplay of investor protection concerns, entrenched national interests and the difficulty of reconciling diverse legal traditions makes it neither feasible nor politically desirable for the European Union to construct a unified equivalence interface for third countries. Yet, even in these areas, the European Union has not abandoned its centralising ambitions. Equivalence continues to serve as a key instrument for gradually consolidating supervisory authority at the EU level, shifting the balance of regulatory power away from the Member States.

4.2 Equivalence Regime in the European Union Issuance Disclosure Framework

4.2.1 Prospectus Regime: The 2003 Prospectus Directive and 2017 Prospectus Regulation

The formulation of the 2003 Prospectus Directive benefited from the European Union's determination to push forward the creation of the Financial Sector Assessment Program (hereinafter FSAP) and the launch of the Lamfalussy process. The pre-FSAP 1998 Commission Communication stated the need to create 'deep and liquid European capital markets which serve both issuers and investors better',²⁷⁴ which would enable all issuers, including small and medium-sized enterprises, to access investment capital as broadly as possible across the entire European Union. This was intended to promote the development of a single capital market within the European Union. By establishing a harmonised prospectus framework within the European Union, a single market passport is provided for issuers, which simplifies cross-border securities issuance procedures within the European Union, while ensuring that investors can obtain sufficient and reliable information. The 2003 Prospectus Directive and the 2003 Market Abuse Directive also provided test cases²⁷⁵ for the new administrative legislative procedure adopted under the Lamfalussy model, mutually promoting the operation and practice of the European Union's four-level legislative framework.

Under the 2003 Prospectus Directive, preparing and publishing a prospectus in compliance with the requirements of the Directive is a necessary prerequisite for offering securities to the public within the European Union. Member states are not permitted to allow any public offer of securities within their territory without prior publication of a prospectus.²⁷⁶ This obligation also extends to securities traded on regulated markets. Member States must

²⁷⁴ European Commission, Financial Services. Building a Framework for Action (1998) (COM 1998) 625) 1.

²⁷⁵ Niamh Moloney, EU Securities and Financial Markets Regulation (3rd edn Oxford University Press 2014) 75.

²⁷⁶ Article 3(1) of 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 L345/64 (2003 Prospectus Directive).

ensure that any admission of securities to trading on regulated markets within their territory is accompanied by the publication of a prospectus.²⁷⁷

The 2003 Prospectus regime is based on the principle of home country control, meaning that no prospectus may be published until it has been approved by the 'home' national competent authority (hereinafter NCA).²⁷⁸ This approach removes the issuer's choice of regulatory jurisdiction and assigns oversight to the NCA on the grounds that the NCA in the issuer's country of incorporation is best suited to supervise prospectus disclosures.²⁷⁹ This decision attracted considerable criticism during the institutional negotiations.²⁸⁰ In response, the Commission made certain concessions, preserving issuer choice for certain bond market offerings, citing a technically convincing reason: to avoid inexperienced NCAs from unprofessionally intervening in well-established bond market segments.²⁸¹ However, overall, the prospectus regime is fundamentally built on supervision by the home country NCA for listed companies.

At the same time, Article 17 establishes the principle of mutual recognition. When a public offer is made or securities are traded in one or more Member States outside the home Member State, a prospectus (and any supplement) approved by the home country's NCA is valid in any number of host Member States for the purpose of that public offer or trading approval.²⁸² A key aspect highlighted in the mutual recognition principle is that the host Member State's regulatory authorities are not allowed to undertake any approval or administrative procedures related to the prospectus. This remains true even if the prospectus contains deficiencies; the home country's NCA retains control over the

²⁷⁷ Article 3(3) Prospectus Directive.

²⁷⁸ Article 13 2003 Prospectus Directive.

²⁷⁹ Recital 14 Prospectus Directive.

²⁸⁰ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 74. The European Parliament also raised concerns with respect to monopoly risks and a loss of concentrated expertise: first parliamentary reading at T5-0114/2003 (and [2003] OJ C47/417) (the report by the Economic and Monetary Affairs Committee (ECON) is at A5-0072/2002 (First ECON Report) Amendments 2 and 16.

²⁸¹ The 2008 CSES Report (See Centre for Strategy & Evaluation Services, *Study on the Impact of the Prospectus Regime on EU Financial Markets. Final Report (2008)*) noted that issuers tended to bring newly issued securities to jurisdictions that held a favourable attitude towards that type of issuance. This led to a specialisation of national competent authorities (NCAs) in specific areas, particularly in the field of third country company employee share schemes, where these companies had some flexibility in choosing their home NCA. France, in particular, was seen as successful in this regard, attracting many third country companies due to its flexible approach to employee share schemes. The report also found a perception that NCAs in Luxembourg and Ireland were more flexible and open to cross-border transactions compared with, for instance, the French NCA.

²⁸² Article 17 2003 Prospectus Directive.

prospectus. The authority to require issuers to provide a prospectus supplement for significant new information, material mistakes or inaccuracies also remains with the home NCAs, while the host NCA and ESMA only have the power to draw the attention of the home NCAs to such issues.²⁸³ Cross-border mutual recognition and regulatory co-operation between Member States is based on notification, as outlined in Article 18 and operates on a NCA-to-NCA basis.²⁸⁴ This framework facilitates co-operation between national regulatory authorities to ensure the smooth functioning of cross-border securities offerings and the consistent application of regulations across the European Union.

The 2003 Prospectus Directive gradually revealed certain problems in practice. First, it was adopted in the form of directives, which meant that they needed to be transposed independently into national law by Member States, rather than being directly applicable EU regulations. This choice of legal form may lead to differences in the interpretation of provisions during the transposition process, resulting in inconsistencies in regulatory content among countries and ultimately affecting the uniformity of information disclosure obligations in their substantive implementation. Furthermore, although regulatory rules have been coordinated (harmonised) at the EU level through directives or regulations to avoid significant disparities between national legislation and practices, the home country control model still provides Member States with greater discretion in implementing information disclosure regulatory obligations. This decentralised regulatory environment limits the integrity of the information disclosure system.

Against the backdrop, the 2003 Prospectus Directive was replaced with the 2017 Prospectus Regulation.²⁸⁵ Compared with the 2003 Prospectus Directive, the new Regulation introduced significant changes in the following three areas:

First, the formal change from a Directive to a Regulation eliminated the complexity in cross-border issuance and fundraising that arose from the flexibility Member States had in transposing the Directive into national law. This ensured that all Member States adhered to

²⁸³ Article 17(2) 2003 Prospectus Directive.

²⁸⁴ Article 18 2003 Prospectus Directive.

²⁸⁵ 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 L168/12 (2017 Prospectus Regulation). It came into full effect on 21 July 2019.

consistent rules, reducing legal uncertainty and compliance burdens caused by the lack of uniformity in the previous framework.

Second, the European Commission, through the 2017 Prospectus Regulation, finally established the principle of maximum harmonisation, reclaiming the regulatory power that Member States previously had under the Prospectus Directive to set stricter or more lenient national laws. As a result, with maximum harmonisation, issuers only need to comply with one set of standards to issue securities in multiple Member States, reducing compliance burdens and legal complexity. At the same time, the unified disclosure requirements ensure that investors receive the same level of information protection, regardless of the EU country in which securities are issued. This reduces information asymmetry and market risk stemming from differences in national laws. Additionally, the newly established maximum harmonisation principle, by setting unified standards and transparency requirements, reduced the opportunities for issuers to engage in regulatory arbitrage by choosing different countries to bypass stricter regulations. This provided a fairer and more reasonable basis for the home NCAs' regulatory authority, ensuring that issuers are subject to consistent oversight across the European Union.

Third, although the Prospectus Regulation retained the home country control model established in the Directive, it introduced some regulatory flexibility by allowing the host country to request additional information from issuers to meet specific local market needs. However, this supplementary information must not alter the original prospectus content. This change marked a shift from the 2003 Prospectus Directive, where the host country could only request the home NCAs to have issuers supplement or update materials. The new regulation strikes a balance between protecting the interests of host country investors and upholding the principle of home country control.

The introduction of the 2017 Prospectus Regulation was the result of the European Commission's ongoing efforts to advance the Capital Markets Union (hereinafter CMU) agenda and strengthen regulatory convergence measures. This regulation achieved a highly harmonised effect in the field of prospectuses.

4.2.1.1 Prospectus Regime, Harmonisation and European Securities and Markets Authority

The European Union actively promotes regulatory convergence in prospectuses, expanding and constructing the prospectus regime centered on the 2003 Prospectus Directive (now replaced with the 2017 Prospectus Regulation) through intensive administrative rule-making. This system is mainly divided into three levels: The first level consists of legislative acts, namely the 2017 Prospectus Regulation (originally the 2003 Prospectus Directive). The second level comprises administrative acts, consisting of the current suite of Commission Regulations²⁸⁶ and the emerging Binding Technical Standards (hereinafter BTS) rulebook, which are used to implement and elaborate on the requirements of the Prospectus Directive/Prospective Regulation. These regulations stipulate the format, content, approval procedures of prospectuses and supplementary information requirements in certain circumstances. At the third level there is a series of non-legally binding soft regulatory convergence measures, such as the Prospectus Questions and Answers (hereinafter Q&A) published by the European Securities and Markets Authority (hereinafter ESMA) and Commission interpretations.²⁸⁷

It is through the administrative rule-making process that the prospectus regime has undergone its most significant expansion. The 2010 Omnibus I Directive²⁸⁸ and the 2014 Omnibus II Directive²⁸⁹ granted ESMA the authority to develop a series of Regulatory Technical Standards (hereinafter RTS) and Implementing Technical Standards (hereinafter ITS) under the 2003 Prospectus Directive. These 'soft rules' become legally binding regulatory rules once adopted by the European Commission. Furthermore, the legislative mandate granted ESMA a range of quasi-regulatory and operational powers and privileges to ensure the smooth implementation of the mutual recognition mechanism between national regulators. This was also aimed at ensuring that the prospectus approval process is unified and coordinated across the European Union, promoting harmonisation among Member State regulators and advancing regulatory convergence. These technical regulatory powers assigned to ESMA were incorporated into, and formalised in, the revised

²⁸⁶ See, for example, Commission Delegated Regulation (EU) 2019/979; Commission Delegated Regulation (EU) 2019/980.

²⁸⁷ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 78.

²⁸⁸ 2010 Omnibus I Directive, 2010/78/EU.

²⁸⁹ 2014 Omnibus II Directive, 2014/51/EU.

2017 Prospectus Regulation.²⁹⁰ The regulation confirmed and strengthened ESMA's role in technical governance and administrative rule-making, further consolidating and enhancing its status as a technocratic authority.

The ESMA plays a pivotal role in shaping and deepening the prospectus regime.²⁹¹ Among the RTS and ITS that ESMA is empowered to develop, some authorisations are highly procedural in nature, such as those related to the NCA approval process, prospectus notifications and co-operation, and information exchange under the ITS framework.²⁹² Other authorisations, such as those involving the prospectus summary template and the administrative rules ensuring uniform application of disclosure requirements, carry substantive regulatory implications.²⁹³ The RTS authorisations go even further, possessing a quasi-rule-making nature. These authorisations involve clarifying key aspects such as the exemption regime, when a prospectus supplement is required and what specific information must be exchanged between national regulatory authorities.²⁹⁴ The 2014 Omnibus II Directive further expanded these authorisations and because it primarily focused on the development of RTS rules, it took on an even stronger quasi-regulatory nature.²⁹⁵

Outside of the formal administrative rule-making process, ESMA has considerable ability to shape and strengthen the prospectus regime. Under its legislative mandate, ESMA can provide the Commission with technical advice concerning the implementation and application of the Directive or Regulation.²⁹⁶ Most of this technical advice is adopted, due to the generally non-contentious nature of the prospectus field, and the strong co-operative relationship between ESMA and the Commission in this area.²⁹⁷

Additionally, beyond the formal administrative rule-making process, ESMA's soft rule-making power has also helped it effectively shape and strengthen the prospectus regime in

²⁹⁰ Prospectus Regulation, 2017/1129.

²⁹¹ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 82.

²⁹² Articles 13(5), 18(3) and 22(4) 2010 Omnibus I Directive.

²⁹³ Articles 5(2) and 7(4) 2010 Omnibus I Directive.

²⁹⁴ Articles 4(3), 16(3) and 22(4) 2010 Omnibus I Directive.

²⁹⁵ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 79

²⁹⁶ Article 22 2003 Prospectus Directive; Article 31 2017 Prospectus Regulation.

²⁹⁷ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 80

practice. ESMA has the authority to issue non-legally binding guidelines and recommendations, such as opinions directed towards national supervisory authorities,²⁹⁸ Q&As,²⁹⁹ and new practical instruments and convergence tools to promote common supervisory approaches and practices.³⁰⁰ Preliminary evidence suggests that, in the absence of special circumstances, national competition authorities are generally reluctant to deviate from ESMA's Q&A.³⁰¹ On the one hand, ESMA emphasises that only courts can provide legally binding interpretations of European Union law and in more contentious areas, ESMA carefully consults the European Commission³⁰². On the other hand, the soft rule-making authority granted to ESMA enables it to clarify the application of the rulebook in financial markets, providing the market with practical and timely guidance on how the regime operates. The multi-level regulatory coordination tools available to ESMA have not only promoted regulatory convergence and rule harmonisation in the prospectus field but also enhanced ESMA's governance capacity as a technocratic authority.

In terms of regulatory co-operation between different Member States in the area of cross-border issuance, ESMA plays a central coordinating role. From the early stages, NCAs coordinate through the Committee of European Securities Regulators (hereinafter CESR), particularly when dealing with new securities, complex products, multiple issuances and requests to suspend or prohibit securities trading in different markets across Member States³⁰³. The ESMA's range of powers to support co-operation, including assisting with authorisation, mediation and participating in home/host country on-site inspections, is designed to strengthen cross-border collaboration between Member States.³⁰⁴

4.2.1.2 The Third Country Equivalence Regime under the Prospectus

The Prospectus regime is characterised by home country control, removing issuer choice and primarily allocating regulatory jurisdiction to the home NCA. These regulatory

²⁹⁸ Article 29(1)(a) ESMA Regulation.

²⁹⁹ Article 16(b) ESMA Regulation.

³⁰⁰ Article 29(2) ESMA Regulation.

³⁰¹ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, Oxford University Press 2014) 8.

³⁰² Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 81.

³⁰³ Committee of European Securities Regulators, *An evaluation of equivalence of supervisory powers in the European Union under the Market Abuse Directive and the Prospectus Directive. A report to the Financial Services Committee* (2007) (CESR/07-334).

³⁰⁴ Articles 31–33, 2017 Prospectus Regulation.

measures reflect the European Union's strong retail market orientation inherent in the prospectus framework.³⁰⁵

For the purposes of financial stability and investor protection, financial sectors dominated by retail markets tend to set higher barriers for third country access through the equivalence regime. The strongest example is that the European Union's banking sector is not included within the scope of the equivalence regime. Under MiFID II/MiFIR, the treatment of third country investment services targeting retail markets and professional clients also follows a dual-track system (to be detailed in the MiFID II/MiFIR section). Similarly, in the prospectus regime, the European Union has maintained a consistent approach with MiFID II/MiFIR when dealing with the retail market, keeping the control over third country issuers' access in the hands of the Member State NCAs. Furthermore, the equivalence regime under the prospectus framework differs significantly from the equivalence regime in the general sense.

Compared with the equivalence regime managed by the European Commission for exempting prospectuses related to third country company employee share schemes³⁰⁶ and to the stricter and more centralised equivalence approach widely adopted during crisis periods in other areas (i.e., EMIR), the disclosure regime for third country prospectuses does not follow a formal equivalence procedure. Although Articles 28–30 specifically outline the equivalence regime for third country prospectuses and the recitals reaffirm the Commission's authority to establish an equivalence framework,³⁰⁷ third country issuers seeking to offer securities to the EU public or to trade securities on a regulated market within the European Union do not require equivalence recognition from the European Commission. Instead, they must obtain approval for their prospectus from the competent authority of the Member State³⁰⁸ where they wish to enter the market. Once approved, they

³⁰⁵ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 109.

³⁰⁶ Article 1(4) of the Prospectus Regulation (Regulation (EU) 2017/1129) outlines the exemption from the prospectus requirement for employee share schemes. Recital 17 further clarifies that, in order to ensure that all directors and employees can equally participate in employee share schemes, regardless of whether their employer is established within or outside the European Union, no additional equivalence decision should be required for third country markets, provided that relevant documents are provided, containing information on the number and nature of the securities, the reasons for and details of the offer, to ensure investor protection. This ensures that all participants in employee share schemes will receive equal treatment and access to information.

³⁰⁷ Recitals 78 and 79 Prospectus Regulation (Regulation (EU) 2017/1129).

³⁰⁸ Article 2(m) of the Prospectus Regulation details how to determine the home competent authority for third country issuers;³⁰⁸ Norton Rose Fulbright, 'Market Access after Brexit: Prospectus Equivalence'

can access other Member State markets through the mutual recognition regime.

According to Article 29, the competent authority of the Member State where the third country issuer is based may approve a prospectus drafted in accordance with, and governed by, the laws of the third country, provided that the information requirements under those third country laws are equivalent to the requirements of the European Union's prospectus regime. Additionally, the relevant regulatory authority of the third country issuer must have established co-operation arrangements with the European Union's home country NCA, as stipulated in Article 30. Under this 'equivalence' arrangement, the equivalence determination within the current prospectus regime is not binding on the competent authorities of Member States, nor does it exempt the prospectus of a third country issuer from being reviewed by the competent authorities. Instead, it is intended to assist the competent authorities in their review of the prospectus. This differs from the typical equivalence regime, which in other financial regulatory areas is based on decisions made by the European Commission.

The requirement for the relevant regulatory authority of a third country issuer to establish co-operation arrangements with the European Union's home NCA is a new provision introduced in the 2017 Prospectus Regulation. It is seen by the industry as the European Union's response to the June 2016 Brexit referendum results.³⁰⁹ Furthermore, the text of the new Prospectus Regulation introduced safeguards to ensure that ESMA and the Commission have greater control when a Member State NCA approves a third country issuer's prospectus. First, the new draft Prospectus Regulation grants the Commission the authority to establish equivalence standards and then determine, through implementing decisions, whether a third country meets these standards.³¹⁰ Secondly, ESMA may (or the Commission may require ESMA to) develop technical standards that specify the minimum content of the 'co-operation arrangements'.³¹¹ With the inclusion of these new provisions, although the authority to approve third country issuers' prospectuses remains with the

(Norton Rose Fulbright Publications 2017).
<https://www.nortonrosefulbright.com/en/knowledge/publications/79f084b3/market-access-after-brexit-prospectus-equivalence>, accessed 13 October 2024.

³⁰⁹ Article 2(m) of the Prospectus Regulation details how to determine the home competent authority for third country issuers;³⁰⁹ Norton Rose Fulbright, 'Market Access after Brexit: Prospectus Equivalence' (Norton Rose Fulbright Publications 2017).
<https://www.nortonrosefulbright.com/en/knowledge/publications/79f084b3/market-access-after-brexit-prospectus-equivalence>, accessed 13 October 2024.

³¹⁰ Article 29, 2017 Prospectus Regulation.

³¹¹ Article 30, 2017 Prospectus Regulation.

home Member State, the Commission and ESMA have been granted stronger veto powers, by imposing additional disclosure requirements and establishing supplementary co-operation arrangements.

To date, the European Commission has not recognised any country as 'equivalent' in the area of prospectuses. In February 2016, ESMA issued an opinion stating that Turkey's disclosure requirements were comparable. However, the European Commission has not yet determined Turkey's equivalence.³¹² In 2011, ESMA established a framework to 'wrap' third country equity prospectuses, essentially adding supplementary information required by the Prospectus Directive, so that the resulting document complies with the EU Prospectus Directive. This innovative 'wrapped' equivalence framework was presented in the form of an ESMA opinion, listing the additional information that third country issuers must provide when their domestic regime is not deemed fully equivalent to the EU regime.³¹³ The ESMA provided a checklist outlining the disclosure items that must be included in the 'wrap' if not required by the third country regime, as well as items that, while not explicitly required, are considered to be provided in an equivalent form. Under this framework, ESMA assesses the equivalence of a specific third country regime. Following this assessment, national regulatory authorities can review the prospectuses submitted for approval. The framework was applied in cases such as Israel in 2011³¹⁴ where ESMA allowed Israeli issuers to list shares on EU markets with the help of such a wrap. Through this innovative approach, the decision-making control over the disclosure obligations required in a prospectus is placed in the hands of ESMA (although the final decision to approve the prospectus remains with the national regulatory authorities).

³¹² ESMA, Opinion, 'Turkish Prospectus Regime Equivalence' ESMA (2016) https://www.esma.europa.eu/sites/default/files/library/2016268_opinion_on_equivalence_of_the_turkish_prospectus_regime.pdf, accessed 13 October 2024.

³¹³ European Securities and Markets Authority Legal Opinion ESMA/2013/317. The equivalence framework was originally adopted as a Public Statement (ESMA/2011/36).

³¹⁴ ESMA, press release, ESMA establishes a framework for third country prospectus and applies this new framework to facilitate Israeli issuers. ESMA/2011/82<https://www.esma.europa.eu/sites/default/files/library/2015/11/11_82.pdf>, accessed 23 March 2011.

4.2.2 Transparency Directive

The Transparency Directive, adopted in 2004, benefited from the commitment to broad consultation under the Lamfalussy process³¹⁵ and was also a significant reform project of the FSAP.³¹⁶ Prior to the adoption of the 2004 Transparency Directive, issuers' ongoing information disclosure obligations were addressed through a patchwork system, which had limited scope and did not support mutual recognition.³¹⁷ Unlike the prospectus regime, the transparency regime does not target specific events; it focuses on the ongoing disclosure obligations of issuers within its scope. The Transparency Directive also lacks the dense set of administrative rules for coordination that characterises the prospectus regime.

The 2004 Transparency Directive³¹⁸ was initially based on minimum harmonisation. A key objective of the Transparency Directive is the home Member State control model, which gives Member States significant discretion to 'gold plate' the regime³¹⁹ (or adopt super-equivalent provisions). Home Member States are explicitly allowed to impose more stringent super-equivalent requirements on issuers than those stipulated in the Directive. As market integration and the process of EU cross-border regulatory convergence advanced, calls for further revisions to the 2004 Transparency Directive grew stronger. The 2013 Amending Transparency Directive³²⁰ reshaped the principle of minimum harmonisation to some extent, leading to a transition towards greater uniformity in cross-border markets between Member States. This reflected widespread market concerns about the costs of divergence (particularly with respect to the ownership notification regime) and

³¹⁵ Extensive consultation took place in July 2001 (Commission, Towards an EU Regime on Transparency Obligations of Issuers Whose Securities Are Admitted to Trading on a Regulated Market (July 2001)) and December 2001 (Commission, Towards an EU Regime on Transparency Obligations of Issuers Whose Securities Are Admitted to Trading on a Regulated Market, Second Consultation by the Services of the Internal Market Directorate General of the European Commission (December 2001)). The Proposal followed in March 2003.

³¹⁶ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 130.

³¹⁷ *ibid*, 128.

³¹⁸ 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 L390/38.

³¹⁹ ESMA 2011 ESMA Mapping Report: Mapping the Transparency Directive; Options, Discretions and Goldplating (ESMA/2011/194).

³²⁰ Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC and Commission Directive 2007/14/EC [2013] OJ L294/13 (Amending Transparency Directive). (Hereafter the 2013 Amending Transparency Directive).

strong support for further harmonisation.³²¹ Following the 2013 Directive reforms, home NCAs were still permitted to impose stricter requirements on issuers than those set out in the Directive.³²² However, they were no longer allowed to require issuers to publish periodic financial information more frequently than the annual and semi-annual financial reports mandated by the Directive.³²³ This aimed to reduce differences between Member States and promote greater uniformity and coordination.

The Transparency Directive also includes an equivalence regime for third country issuers whose securities are admitted to trading on a regulated market and thus fall within the ongoing disclosure framework of the Directive. If the issuer's registered office is in a third country, the competent authority of the home Member State may exempt the issuer from certain disclosure obligations under the Transparency Directive, provided that the third country's laws specify disclosure obligations equivalent to those of the European Union's Transparency Directive or the third country's legal requirements that the issuer complies with are deemed equivalent by the home Member State's competent authority.³²⁴

The equivalence regime under the Transparency Directive still reflects the home country control principle,³²⁵ with the home NCAs serving as the authority for granting equivalence recognition. However, similar to the prospectus regime, the Commission retains the power to establish a unified mechanism to ensure the harmonisation of equivalence recognition across Member States.³²⁶ The mechanism established by the Commission for determining third country equivalence standards includes, but is not limited to, the financial statements of third country companies, other disclosure requirements mandated by third country laws, regulations or administrative provisions and practices or procedures based on international standards set by international organisations that align with EU standards. The most important aspect of this mechanism is the recognition of financial statements, as it forms the core of financial information disclosure.

Similar to the Prospectus regime, ESMA plays a key technocratic governance role in the area of the Transparency Directive. The European Securities and Markets Authority has

³²¹ Mazars, Study on the Transparency Directive Assessment Report (Report for the European Commission, Internal Market and Services DG, 2009) xi–xii.

³²² Article 3, 2004 Transparency Directive.

³²³ Article 4, 2013 Amending Transparency Directive.

³²⁴ Article 23(1), 2004 Transparency Directive.

³²⁵ Article 19, 2004 Transparency Directive .

³²⁶ Article 23(3), 2004 transparency Directive.

issued a series of guidance documents, RTS and ITS to clarify or supplement the requirements of the Directive. These efforts help national regulatory authorities across Member States adopt uniform standards in areas such as information disclosure, financial reporting and changes in shareholder rights.³²⁷ For example, ESMA developed the unified European Single Electronic Format (hereinafter ESEF) for companies to use when publishing their annual and semi-annual reports, aiming to help investors analyse and compare reports from different jurisdictions. ESMA also developed tools such as the European Electronic Access Point (hereinafter EEAP), a centralised platform for accessing statutory information from listed companies across EU Member States. This initiative aims to harmonise access to financial information, making cross-border data more accessible to investors and enhancing the standardisation and accessibility of information disclosure across the European Union.³²⁸ The issuance and implementation of these technical standards have enhanced the transparency and consistency of EU capital markets.

The European Union, through the ongoing release of guidance documents and the Q&A mechanism (particularly under ESMA's coordination), has further clarified the scope and specific implementation requirements of the Transparency Directive. This guidance helps Member States maintain consistent standards and ensures that cross-border companies face uniform transparency requirements. The ESMA also serves as a cross-border coordinator at the EU level, overseeing the coordination of information sharing and co-operation among national regulatory authorities. Following the 2013 amendments, while national regulators remain the primary enforcement bodies, ESMA's role has evolved from being a mere coordinator to a regulator with increasing direct supervisory and enforcement powers.

However, in the area of the Transparency Directive, the strength of administrative coordination and institutional integration is far less than that in the prospectus field. Although the Transparency Directive was revised in 2013 in response to market changes, it still maintained the legal form of a directive and did not achieve full 'maximum harmonisation'. As a consequence, a third country firm still needs to comply with different

³²⁷ The compilation of various soft rules issued by ESMA under the Transparency Directive, including interpretative acts (hereinafter IA), regulatory and implementing technical standards (RTS/ITS) and Q&As, illustrates the scope of ESMA's involvement in shaping the implementation of the Directive. These materials are accessible via ESMA's Interactive Single Rulebook platform: <https://www.esma.europa.eu/publications-and-data/interactive-single-rulebook/transparency-directive>.

³²⁸ ESMA, 'Electronic Reporting' (ESMA) <<https://www.esma.europa.eu/issuer-disclosure/electronic-reporting>>, accessed 13 October 2024.

equivalence requirements on disclosure in its operations. This has, to some extent, weakened the achievement of regulatory consistency in this area.

4.3 The Equivalence Regime in the Credit Rating Agencies Sector

A Credit Rating Agency (hereinafter CRA) is an institution specialised in assessing the creditworthiness of issued debt instruments (e.g., corporate bonds, government bonds, securities) or borrowing entities (e.g., companies, governments) and providing credit ratings. These ratings reflect the credit risk of the debt instrument or borrowing entity, namely their ability to fulfil financial obligations on time. As financial intermediaries, CRAs play a role in enhancing market efficiency and ensuring effective resource allocation. Their fundamental function is to address the problem of information asymmetry and help investors evaluate the default risk of financial products.³²⁹

In the years leading up to the outbreak of the global financial crisis in 2008, CRAs were essentially unregulated. In the European Union, whether at the Member State or union level, CRAs were not subject to any specific registration procedures (as all major international agencies were located in the United States), but were merely expected to comply with the international code of conduct for CRAs published by the International Organization of Securities Commissions (hereinafter IOSCO). The financial crisis exposed the risks that CRAs brought to the market due to conflicts of interest and high concentration. In Europe, in April 2008, the European Parliament's Committee on Economic and Monetary Affairs called for the establishment of a European public rating agency by the European Commission.³³⁰ The aim was to formulate rules for existing agencies to address the inherent 'conflicts of interest' in their current business models.

According to the Credit Rating Agencies Regulation (hereinafter CRAR), only credit ratings issued by third country credit rating agencies (hereinafter TC CRAs) that are established, registered in the European Union and comply with the regulatory requirements of the CRAR can be used by EU-regulated financial entities.³³¹ These ratings are utilised to assess their credit risk in the market and to meet regulatory requirements related to capital

³²⁹ Andrea Miglionico, *The Governance of Credit Rating Agencies* (Edward Elgar Publishing 2019) 259.

³³⁰ European Parliament Committee on Economic and Monetary Affairs, *Draft Report with Recommendations to the Commission on Hedge Funds and Private Equity*, Strasbourg, 18 April 2008 (2007/2238(INI)).

³³¹ Credit Rating Agencies Regulation, Title III, Chapter 1 (Registration Procedure).

adequacy or liquidity management. For example, under the Basel Accords, banks are required to calculate capital adequacy ratios based on asset risk weights, where credit ratings are a key factor in determining these risk weights.

Although the European Union has imposed restrictions on the use of credit ratings issued by TC CRAs, it is, in practice, difficult to prevent EU market participants from using ratings provided by TC CRAs. This is because the CRA market is a highly concentrated segment of financial services,³³² with the headquarters of the three major CRAs all located in the United States. Therefore, CRAR includes specific provisions for the access of TC CRAs. To have certain credit ratings recognised, TC CRAs must comply with standards established under EU law and there must be appropriate co-operation arrangements between the European Union and the third country regulatory authorities.³³³

The European Union regulates the access of third country CRAs primarily through two mechanisms: (1) the endorsement procedure (for systemic TC CRAs) and (2) the certification/equivalence procedure (for non-systemic TC CRAs). These mechanisms aim to ensure that third country credit ratings comply with the European Union's high regulatory standards while maintaining financial market stability and transparency.

Given the highly monopolistic nature of the CRA market, in practice, just a few of TC CRAs gain access to the EU market through the equivalence procedure.³³⁴ This is because non-systemic TC CRAs inherently have lower market shares, which also means that their credit ratings lack the widespread market acceptance and credibility enjoyed by systemic TC CRAs.

4.3.1 Access Approach I: Endorsement procedure

Systemic TC CRAs are required to establish a subsidiary within the EU internal market. This EU subsidiary must apply for registration with ESMA and endorse the third country ratings issued by the parent company as part of the same group,³³⁵ in other words, once the

³³² Andrea Miglionico, *The Governance of Credit Rating Agencies* (Edward Elgar Publishing 2019).

³³³ Article 4(3), CRAR.

³³⁴ Niamh Moloney, 'Third Countries and EU Financial Market Access: Technocracy, Politics and the End of Deference?' in T Jaeger et al. (eds), *Consolidating Brexit* (Verlag Publishing 2023).

³³⁵ Credit Rating Agencies Regulation (CRAR), Art. 4(2).

endorsement procedure applies, it implies that the TC CRA and the EU CRA belong to the same corporate group.

According to the provisions of the CRAR, an EU CRA, as a subsidiary, may only endorse ratings issued by a TC-CRA when the following conditions are fulfilled:³³⁶

- (a) The endorsing CRA and the TC CRA belong to the same financial group
- (b) The endorsing CRA can demonstrate to ESMA that the regulatory requirements adhered to by the TC CRA in its home country are 'as stringent' as those specified in the CRAR
- (c) ESMA is able to assess and supervise whether the TC CRA complies with these third country rules, which are considered 'as stringent' as EU law
- (d) The endorsing CRA provides ESMA with all necessary information
- (e) There are 'objective reasons' indicating that the rating should be conducted in the third country rather than in the European Union
- (f) The TC CRA is authorised and supervised by the competent authority in its home country
- (g) The laws of the third country prohibit its competent authorities from interfering in the operations and rating methodologies of the TC CRA
- (h) A Memorandum of Understanding (hereinafter MoU) has been signed between ESMA and the relevant competent authorities of the third country.

The endorsing EU CRA shall bear 'full and unconditional responsibility for the ratings issued by the endorsed CRA and the fulfilment of the aforementioned standards.'³³⁷ It also needs to demonstrate to ESMA that it has effective control over the TC CRA.

³³⁶ *ibid*, Art. 4(3).

³³⁷ *ibid*, Art. 4(4).

4.3.2 Access Approach II: Certification/Equivalence Procedure

The Certification/Equivalence Procedure applies to non-systemically important TC CRAs. These smaller-scale TC CRAs are typically not required to establish subsidiaries within the EU jurisdiction and can gain access to the EU market directly based on an equivalence decision for their home jurisdictions by the European Commission. Under the certification procedure, of course, these TC CRAs are still required to individually undergo a procedural application for certification to ESMA in order to operate within the European Union thereafter.³³⁸ Once a TC CRA receives certification, ratings issued by it can be used in the European Union for regulatory purposes, such as capital requirements calculations. However, these ratings are typically applicable to non-EU issuers or non-EU financial instruments and are not directly targeted at EU entities (i.e., EU Member State governments, EU institutions or EU-supported projects).

- (a) TC CRAs seeking access to the EU market through the Certification/Equivalence Procedure must meet the following requirements:³³⁹
- (b) They must be authorised and supervised in their home country
- (c) They must be legally registered in a jurisdiction deemed equivalent by the European Commission
- (d) A co-operation arrangement must be signed between ESMA and the third country authority involved

The ratings issued by the TC CRA must not have systemic importance for the financial stability or market integrity of one or more EU Member States.

Table 4.1 outlines the comparison between the two access mechanisms:

³³⁸ *ibid*, Art. 5(2).

³³⁹ *ibid*, Art. 5(1).

Table 4.1: Comparison between the two access mechanisms for CRAs

Criteria	Endorsement	Certification
Scope of application	For third country credit rating agencies (CRA) closely linked to a European Union-registered CRA (e.g., part of the same group).	For independent third country credit rating agencies with limited impact on the European Union market.
Regulatory equivalence	Required: The third country's regulatory framework must be deemed equivalent to the European Union's standards.	Required: The third country's regulatory framework must also be deemed equivalent.
Co-operation arrangement	A formal co-operation agreement must exist between the Generally Accepted Accounting Principles and the third country regulator.	A formal co-operation agreement is also required.
European Union credit rating agency involvement	Mandatory: A European Union-registered credit rating agency must endorse and take legal responsibility for the third country credit rating agency's ratings.	Not required. The third country credit rating agencies can apply independently.
Market usage	Endorsed ratings can be widely used across the European Union market, treated as if they were issued by a European Union credit rating agency.	Certified ratings are only valid in cases where the impact on the European Union market is limited, notably 'not of systemic importance to the financial stability or integrity of the financial markets' to the European Union market

For certificated TC CRAs, the European Union adopts a deferential model, exercising a more relaxed level of control. The ESMA does not supervise these non-systemic CRAs, but, instead, relies 'almost entirely' on their third country regulatory authorities. In contrast, for TC CRAs accessing the EU market through the endorsement procedure, ESMA effectively gains indirect supervisory power over them. This is because these systemic TC CRAs

should establish EU subsidiaries within the internal market, which fall under ESMA's daily supervisory authority.³⁴⁰

The design of the European Union's access mechanisms for TC CRAs reflects a dual purpose: protecting the EU market and promoting international co-operation. On the one hand, by ensuring that ratings issued by TC CRAs comply with EU standards, it prevents the impact of low-quality or high-risk ratings on the EU market. On the other hand, through the endorsement and certification/equivalence mechanisms, the EU fosters regulatory coordination with other countries while strengthening oversight of TC CRAs.

4.3.3 The Implementation of the Certification Procedure

In 2010, Japan was the first country to be recognised as equivalent by the European Commission.³⁴¹ Subsequently, in 2012, three more countries were recognised in the same 'batch': (1) the United States, (2) Australia and (3) Canada.³⁴² In 2014, the European Commission adopted another set of decisions, recognising the regulatory frameworks of four additional jurisdictions: (1) Argentina, (2) Mexico, (3) Brazil and (4) Hong Kong.³⁴³

The latest version of the European Union's CRA regulation, Regulation (EU) No. 462/2013, came into effect on 20 June 2013 and is commonly referred to as *CRA III*. Building on the previous two amendments, this version further strengthens the regulation of CRAs, particularly by enhancing requirements for managing conflicts of interest, improving transparency in ratings and introducing stricter rules for sovereign ratings.

The amendments to the CRAR prompted ESMA to re-evaluate the equivalence decisions previously made under the earlier EU regulatory framework to determine whether the

³⁴⁰ See the description of the two different supervisory approach on the ESMA website: <<https://www.esma.europa.eu/supervision/non-eu-credit-rating-agencies>>

³⁴¹ European Commission Decision of 28 September 2010 on the Recognition of the Legal and Supervisory Framework of Japan as Equivalent to the Requirements of Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies [2010] OJ L 201/40.

³⁴² European Commission Implementing Decisions (EU) 2012/627/EU, 2012/628/EU, 2012/630/EU of 5 October 2012 on the Recognition of the Legal and Supervisory Framework of Australia, of Canada and of the United States of America as Equivalent to the Requirements of Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies, [2012] OJ L 201/26.

³⁴³ European Commission Implementing Decisions 2014/247/EU, 2014/245/EU, 2014/249/EU, 2014/248/EU of 28 April 2014 on the Recognition of the Legal and Supervisory Framework of Singapore, of Hong Kong, of Brazil, of Mexico, of Argentina as Equivalent to the Requirements of Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies [2014] OJ L 201/43.

regulatory requirements for CRAs in other jurisdictions still achieved outcomes-based equivalence under the updated CRA III. To provide equivalent third countries time to adjust their regulatory frameworks, the amended CRAR included a provision specifying that certain new legal requirements introduced in 2013 would only become mandatory conditions for attaining equivalence status after 1 June 2018.³⁴⁴

In 2017, the European Commission requested ESMA to provide new technical advice on the regulatory regimes of jurisdictions already considered equivalent. The ESMA's study, published in the same year, revealed that certain 'equivalent' jurisdictions did not meet the requirements established under the revised CRAR.³⁴⁵ The European Commission required these jurisdictions to 'update' their regulatory frameworks in line with the new EU regime. After two years of negotiations, the Commission revoked the equivalence status of all countries that failed to align their regimes dynamically with the revised CRAR. Consequently, the equivalence decisions for Argentina, Australia, Brazil, Singapore and Canada were withdrawn.³⁴⁶ At the same time, the equivalence status of the United States, Japan, Mexico and Hong Kong was newly reaffirmed.³⁴⁷

The European Commission's review exerted significant influence on the regulatory frameworks for TC CRAs. Canadian regulators even proposed amendments to Canada's regulatory regime 'for the Union to continue to recognize the Canadian regulatory regime as equivalent for regulatory purposes in the Union'. However, the legislative amendment plans were ultimately 'shelved', resulting in the withdrawal of Canada's equivalence status.³⁴⁸ As of 21 November 2024, there are three non-systemic TC CRAs operating in the

³⁴⁴ European Commission, 'Report from the Commission to the European Parliament and the Council on the Exercise of the Power to Adopt Delegated Acts Conferred on the Commission Pursuant to Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on Credit Rating Agencies' (2014) COM/2014/0743 final.

³⁴⁵ European Securities and Markets Authority, Final Report. Technical Advice on CRA Regulatory Equivalence: CRA 3 update, 17 November 2017, ESMA 33-09-207.

³⁴⁶ European Commission Implementing Decision (EU) 2019/1277 of 29 July 2019 Repealing Implementing Decision 2012/630/EU on the Recognition of the Legal and Supervisory Framework of Canada as Equivalent to the Requirements of Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies, [2019] OJ L 201.

³⁴⁷ European Commission Implementing Decisions (EU) 2019/1283, 2019/1280, 2019/1279, 2019/1284 of July 2019 on the Recognition of the Legal and Supervisory Framework of Japan, of Mexico, of the United States of America and of Argentina as Equivalent to the Requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies, [2019] OJ L 201.

³⁴⁸ See European Commission Implementing Decision (EU) 2019/1277 of 29 July 2019 Repealing Implementing Decision 2012/630/EU on the Recognition of the Legal and Supervisory Framework of Canada as Equivalent to the Requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies, [2019] OJ L 201.

European Union (EU) under the certification procedure: one in the United States, one in Mexico and one in Japan.³⁴⁹

4.3.4 The Implementation of the Endorsement Procedure

For TC CRAs, the endorsement procedure is more significant than the certification procedure, as globally active CRA groups heavily rely on it. Over two-thirds of all ratings used in the internal market are not directly issued within the European Union, but are, instead, produced by TC-CRAs and subsequently endorsed by EU-based entities.³⁵⁰ As previously mentioned, ratings issued by TC CRAs can be endorsed by EU CRAs, provided that the latter can demonstrate that the TC RA complies with requirements that are 'as stringent as' those under CRAR.³⁵¹

Although the European Union procedurally distinguishes the endorsement procedure from the certification/equivalence procedure, the initial stage of the endorsement procedure also relies on the equivalence status of the third country regulatory framework with the European Union's CRAR. In an interpretative guideline issued in 2011, ESMA introduced a streamlined process to conduct the 'as stringent as' test.³⁵² The 2011 guideline advocated a deferential approach, whereby once ESMA determined that a third country's regulatory framework for CRAs achieved equivalence with CRAR, the 'as stringent as' test was considered passed. Thereafter, EU-based CRAs could endorse ratings from third countries. Of course, since systemic TC CRAs are required to establish subsidiaries within the EU jurisdiction as endorsing CRAs, ESMA thereby holds direct supervisory and intervention powers over the endorsing CRA. This ensures stronger regulatory control over systemic TC CRAs under the endorsement procedure. Based on the equivalence status determination, under the Endorsement Procedure, ESMA has recognised the regulatory frameworks of 11 jurisdictions as being 'as stringent as' CRAR.³⁵³

³⁴⁹ European Securities and Markets Authority website for a list of registered or certified CRAs: 'CRA Authorisation' <<https://www.esma.europa.eu/credit-rating-agencies/cra-authorisation>>.

³⁵⁰ European Securities and Markets Authority, 'ESMA Clarifies Endorsement Regime for Third country Credit Ratings', 17 November 2017 <<https://www.esma.europa.eu/pdf>>

³⁵¹ Credit Rating Agencies Regulation, Art. 4(3)(b).

³⁵² European Securities and Markets Authority, Guidelines on the Application of the Endorsement Regime Under Article 4(3) of the CRA Regulation, (ESMA/2011/139) adopted in May 2011.

³⁵³ Those jurisdictions are: Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore, South Africa, United Kingdom, and the US. See the ESMA website: 'CRA Authorisation' <<https://www.esma.europa.eu/credit-rating-agencies/cra-authorisation?>>

However, in 2017, ESMA decided to review the interpretative guideline.³⁵⁴ Under the new approach, TC CRAs can no longer satisfy the 'as stringent as' test simply by complying with their third country legal frameworks. The endorsing EU CRA must be able to confirm that the third country-endorsed CRA has established 'internal requirements which are at least as stringent as the corresponding requirements' in the CRAR. Furthermore, ESMA expects TC CRAs to comply with these internal requirements on an ongoing basis.³⁵⁵ At the same time, ESMA explicitly outlined the elements it expects the 'as stringent as' CRAR internal requirements to include.³⁵⁶ In other words, ESMA's original 2011 approach was deferential, as it assumed that when a TC CRA was located in a jurisdiction with a regulatory framework positively assessed by ESMA, it automatically satisfied the 'as stringent as' test. Consequently, it allowed the ratings of TC CRAs to be endorsed based on their home country's regulation and supervision (as long as ESMA had previously recognised the framework as 'as stringent as' CRAR), rather than requiring direct compliance with CRAR requirements.

The new approach, which came into force in 2019, requires TC CRAs to comply with EU law requirements when adopting ratings to be endorsed by EU CRAs. This represents a significant shift in regulatory philosophy, reflecting ESMA's move from traditional international deference to a more intrusive and control-oriented regulatory model. The endorsement procedure, in effect, grants ESMA the power to monitor the conduct of TC CRAs whose ratings are endorsed by the EU entity indirectly, especially following the 2019 review.

ESMA can rely on a vast range of direct supervisory powers over endorsing CRAs, such as the request for information 'by a simple request' or 'by a decision', investigations and on-site inspections.³⁵⁷ In addition, as a direct result of its supervisory mandate over EU CRAs, ESMA also serves or participates in global supervisory colleges established by IOSCO,

³⁵⁴ European Securities and Markets Authority, Update of The Guidelines on the Application of the Endorsement Regime Under Article 4(3) of the Credit Rating Agencies Regulation, Final Report, 17 November 2017, ESMA33-9-205 (hereinafter ESMA 2019 Guideline).

³⁵⁵ Article 12 and 13, ESMA 2019 Guideline.

³⁵⁶ Article 15, ESMA 2019 Guideline.

³⁵⁷ Credit Rating Agencies Regulation, Arts 23b–23d.

which include each globally systemic CRA. This international role is made possible due to ESMA's supervisory responsibilities under the CRAR.³⁵⁸

The endorsement procedure this entails a mixture of *relocation* (obligation of systemic TC CRAs to establish a subsidiary in the European Union) and *ESMA supervision* (ESMA supervises the endorsed TC CRAs via the endorsing EU CRAs).³⁵⁹ Over more than a decade of practice, ESMA's regulatory approach appears to be 'robust and intrusive'.³⁶⁰

4.4 Equivalence Regime in the European Union Fund Industry

4.4.1 Introduction to the European Union Fund Regime

Investment funds collect capital from investors and conduct collective investments through a combination of financial instruments such as stocks, bonds and other securities,³⁶¹ with a view to achieving economies of scale in collective investment, diversifying risks and generating profit returns for investors. In the European Union, the management framework for such collective investment schemes (hereinafter CISs) is implemented through the Undertakings for Collective Investment in Transferable Securities (hereinafter UCITS Directive)³⁶² and the Alternative Investment Fund Managers Directive (hereinafter AIFMD)³⁶³.

The design of UCITS funds focuses on retail investors and must therefore adhere to strict rules to protect investors' interests. Those CISs under the UCITS Directive shall meet specific framework design, while the fund structures covered by the AIFMD are much more flexible. The AIFMD is oriented towards the professional market, thus the AIFMD

³⁵⁸ IOSCO, 'Supervisory Colleges for Credit Rating Agencies', final report, July 2013, <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD416.pdf>>

³⁵⁹ Francesco Pennesi, *Equivalence in Financial Services: A Legal and Policy Analysis* (Springer 2022) 119.

³⁶⁰ European Securities and Markets Authority, 'ESMA Strategic Orientation 2016-2020', ESMA/2015/935, 15 June 2015. See also European Court of Auditors, *EU Supervision of Credit Rating Agencies: Well Established but not yet Fully Effective*, Special Report <https://www.eca.europa.eu/lists/ecadocuments/sr15_22/sr_esma_en.pdf>

³⁶¹ Francesco Pennesi, *Equivalence in Financial Services: A Legal and Policy Analysis* (chap 7 Springer Nature 2022).

³⁶² 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 L302/32, as amended by Directive 2014/91/EU [2014] OJ L257/186.

³⁶³ 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 L174/1.

does not require CISs to adopt a specific design model, but, instead, serves as a broad 'default framework' applicable to all investment funds that do not opt for the UCITS regime. These funds, referred to as *alternative investment funds* (hereinafter AIFs), encompass a wide range of categories, including hedge funds, private equity funds, real estate funds and infrastructure funds.

The Undertakings for Collective Investment in Transferable Securities operates as an opt-in regime. If a fund or its manager does not choose to adopt the UCITS design model, it automatically falls under the regulatory scope of the AIFMD, as the applicability of these two directives is, in principle, mutually exclusive. The AIFMD is thus the default legislation, while the UCITS Directive serves as a *lex specialis* to the AIFMD.³⁶⁴

The AIFMD covers all collective investment schemes that do not meet the UCITS definition, regardless of whether they target retail or professional investors³⁶⁵ and irrespective of their investment strategies or asset classes. The AIFMD imposes fewer restrictions on investment targets and strategies, allowing funds to use leverage, invest in complex derivatives, unlisted securities, real estate and other high-risk assets, thereby catering to the needs of professional investors.

Although the UCITS Directive was the first to open the EU financial market to fund products from other Member States, it does not establish any third country framework: both UCITS managers and funds need to be established in the internal market.³⁶⁶ Third country fund managers without a physical presence in the European Union who market non-EU funds within the European Union are automatically regulated under the AIFMD as qualified non-EU AIFs and non-EU AIFMs.

4.4.2 Equivalence Recognition Access to Internal Passporting Under the Alternative Investment Fund Managers Directive

Before the 2008 global financial crisis, the European Union lacked unified legislation to regulate the AIF industry, leaving each Member State to adopt its own regulatory

³⁶⁴ Dirk A Zetsche, 'The Anatomy of European Investment Fund Law' in William A. Birdthistle and John Morley (eds), *Research Handbook on the Regulation of Mutual Funds* (Edward Elgar Publishing 2018).

³⁶⁵ The AIFMD applies primarily to funds aimed at professional investors, but it also allows certain funds to provide services to high-net-worth individuals.

³⁶⁶ Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, Art 1 (1).

approach.³⁶⁷ This changed in 2011 with the adoption of the AIFMD, which introduced a harmonised set of rules at the EU level.³⁶⁸ Although AIFs are required to adhere to the unified regulatory rules established by the AIFMD, the day-to-day supervisory work for AIFs is primarily carried out by national regulators and authorities;³⁶⁹ that means the regulation of AIFs also follows the principle of home country control.

The AIFMD lays down two possible routes for non-EU AIFMs to access the EU internal market. The first is through national private placement regimes (hereinafter NPPRs), which are administered by the competent authorities of individual Member States. Under this mechanism, a non-EU AIFM must negotiate market access separately with each host country and non-EU funds cannot obtain passporting rights, meaning they may only operate within the jurisdiction of the host state concerned. The second route is a 'third country passporting right', which may be activated by the European Commission on the basis of an equivalence assessment. In this case, non-EU AIFMs could benefit from a single passport granting access to the entire EU internal market, thereby overcoming national boundaries. However, the equivalence framework under the AIFMD has so far remained only on paper and has not been put into practice. Moreover, the design of the equivalence regime in the AIFMD differs considerably from that set in other areas of EU financial services law. The following section sets out this regime:

4.4.3 Equivalence for Non-European Union Alternative Investment Funds/Alternative Investment Fund Managers Marketing

Under the AIFMD, the core function of the 'equivalence' mechanism lies in facilitating the cross-border marketing of non-EU funds, rather than granting access to fund management activities. The Alternative Investment Fund Managers Directive adopts a strict territorial approach towards management: any fund established or managed within the European Union must be operated by an authorised EU AIFM. For funds established in the European

³⁶⁷ Eddy Wymeersch, 'The Regulation of Private Equity, Hedge Funds and State Funds' in Guido Ferrarini, Eddy Wymeersch and Klaus J Hopt (eds), *Regulation of Hedge Funds and Private Equity: Lessons from the Global Financial Crisis* (Oxford University Press 2012).

³⁶⁸ 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, <<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02011L0061-20140702&qid=1491838864981&from=EN>>

³⁶⁹ Regarding how to determine whether a CIS is an EU fund by confirming the country of registration, see D Zetzsche and R Veidt, 'The AIFMD's third country rules and the equivalence concept' in D Zetzsche (ed) *The Alternative Investment Fund Managers Directive* (3rd edn Wolters Kluwer 2020) 795.

Union (i.e., EU AIFs), their management must be carried out by a licensed EU AIFM, regardless of whether the manager originates from within or outside the European Union. Where the manager is based in a third country, it must establish a branch or subsidiary in the European Union and obtain the requisite authorisation. Even if a non-EU manager intends to manage non-EU AIFs from within the Union, the branch in question must still be authorised by the competent authority of the Member State and comply fully with the AIFMD.

It follows that the access requirements for management are stringent and virtually closed, leaving no scope for the application of the equivalence clause. By contrast, the equivalence framework under the AIFMD is designed solely to provide a potential passporting route for the cross-border marketing of non-EU funds. Specifically, where the regulatory, supervisory and enforcement framework of a third country is assessed and recognised by the European Commission as 'equivalent' to the AIFMD, fund managers and funds from that jurisdiction may, subject to certain conditions, obtain a marketing passport enabling them to engage in cross-border marketing within the European Union. However, it is important to note that this equivalence passport mechanism has not yet been formally activated. At present, non-EU AIFMs and AIFs continue to rely primarily on the national private placement regimes (NPPRs) of individual EU Member States in order to market within the European Union.

National private placement regimes refers to frameworks established by EU Member States that allow non-EU AIFMs and/or non-EU AIFs to distribute their funds within the respective Member State. These regimes focus on the marketing of offshore AIFs and/or AIFMs to limited domestic markets within individual EU Member States, rather than the EU single market. As a transitional arrangement, NPPRs provide a restricted market access mechanism for non-EU AIFMs and/or non-EU AIFs to enter the EU market. National private placement regimes are not a unified EU mechanism but are, instead, developed by individual Member States based on their national laws and regulations. This means each Member State can decide whether to permit NPPRs and under what conditions they may operate. Although the AIFMD also sets out a series of minimum compliance requirements, it has established EU-level coordination for NPPRs, thereby ensuring that non-EU funds,

when marketed to professional investors in the European Union, must comply with certain harmonised disclosure and regulatory standards.³⁷⁰

The issue here is that private placement rules vary across each EU country. In fact, some EU countries effectively block non-EU funds because they do not permit marketing to investors within their jurisdiction without an AIFMD passport. The differential treatment between EU AIFMs and non-EU AIFMs has led to criticism that the AIF industry has created a 'European fortress' in the alternative investment fund sector.³⁷¹

In contrast, the 2011 AIFMD envisioned extending the passport to non-EU AIFMs and non-EU AIFs. Article 41 of the AIFMD provides that non-EU AIFMs can obtain an EU-wide management passport upon authorisation in their EU Member State of Reference (hereinafter MSR), similar to the management passport available to EU AIFMs. This means that, under the management passport, non-EU AIFMs can manage EU AIFs established in Member States other than their MSR, either on a cross-border basis or by establishing a branch in the host country. It has authorised ESMA to provide advice in this regard to the European Parliament, the Council and the European Commission.

- (a) The AIFMD passport system allows managers authorised in one Member State to operate freely across the entire EU market. According to Articles 37 to 41 of the AIFMD, third country AIFMs must meet the following conditions to obtain a passport:
- (b) *Compliance with regulatory requirements:* The legal framework of the third country AIFM's home country must be assessed as equivalent to the AIFMD and have a robust regulatory co-operation mechanism in place.
- (c) *Establishment of a legal representative:* A legal representative must be established in the European Union to act as the entity responsible for legal accountability, ensuring compliance with, and enforcement of, AIFMD rules. Third country AIFMs that cannot meet the requirement of establishing a physical entity in the European Union are not allowed to market their funds within the European

³⁷⁰ Article 42 AIFMD.

³⁷¹ Francesco Pennesi, *Equivalence in Financial Services: A Legal and Policy Analysis* (ch 7 Springer Nature 2022).

Union.³⁷²

Regulatory co-operation agreement: A regulatory co-operation agreement must be signed between the EU Member State and the third country to enable information sharing and coordinated supervision.

Once the third country passport system envisioned by the AIFMD is activated, non-EU AIFMs can use the pan-European marketing passport after obtaining AIFM authorisation within the European Union. The authorising authority will be the regulator of the AIFM's MSR. Authorisation in the MSR requires full compliance with the requirements of the AIFMD. Additionally, non-EU AIFMs must appoint a legal representative in the MSR.³⁷³ In the European Union's vision, the 'activation' of this passport framework will phase out the NPPRs regime.

Article 67(2) of the AIFMD outlines the issues ESMA must consider in the third country regime, with particular focus on the challenges and effectiveness of co-operation arrangements between third country and EU authorities. Considering reciprocity, it also includes an assessment of any difficulties faced by EU AIFMs when establishing or marketing AIFs in third countries.

The third country passport scheme has made some progress. In the latest round of assessments in 2016, only five out of 12 non-EU countries received unqualified advice (with the remaining seven jurisdictions, including the United States and Hong Kong, receiving qualified advice).³⁷⁴ Brexit has disrupted that process, as the United Kingdom hosts the largest fund management industry involving the European Union,³⁷⁵ for example, with some 37 per cent of assets under management in the European Union managed in the United Kingdom.³⁷⁶ Overall, some 35 per cent of all wholesale financial services activity in

³⁷² Article 42 AIFMD.

³⁷³ Article 37(6) AIFMD.

³⁷⁴ European Securities and Markets Authority 'ESMA Guidance on AIFMD passport to non-EU Countries: Go Slow Persists. <https://www.aima.org/journal/aima-journal-edition-108/article/esma-guidance-published-on-application-of-theaifmd-passport-to-non-eu-countries-go-slow-persists.html>. Accessed 23 Sept 2019.

³⁷⁵ International Monetary Fund, 'UK financial sector assessment program, financial system stability assessment', (2016) IMF Country Report 16/167 9.

³⁷⁶ M Magnus, A Margerit and B Mesnard, 'Brexit: The United Kingdom and EU financial services', EU Parliament Briefing Paper, 9 December 2016.
<[https://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587384/IPOL_BRI\(2016\)587384_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587384/IPOL_BRI(2016)587384_EN.pdf)>

the European Union takes place in the United Kingdom.³⁷⁷ The instability in the fund market caused by the United Kingdom's Brexit disrupted the European Union's original idea of uniformly granting passporting to third countries, gradually replacing NPPRs and reclaiming Member State autonomy. The concept of the third country passport for non-EU AIFMs must be activated by the European Commission through a delegated act, following ESMA's technical advice. However, to date, this envisioned third country passport access has never been activated by the Commission and remains merely a concept on papers.

4.4.4 Equivalence that Differs from Other Financial Sectors

It is evident that equivalence recognition constitutes a key element of the third country access approach once the AIFMD third country passporting right is activated, since obtaining such recognition is a prerequisite under the AIFMD for extending the passport regime to non-EU AIFs and AIFMs, thereby granting them the same single market access rights previously reserved for EU Member States.

It must also be noted that the equivalence regime under the AIFMD framework differs substantially from those referred to in other areas. Even though the AIFMD introduces an equivalence clause allowing third country AIFs/AIFMs to conduct cross-border marketing within the European Union and thereby expand their market reach – thus facilitating cross-border flows – the AIFMD simultaneously requires full compliance by third country AIFs/AIFMs with EU rules. This is fundamentally different from the equivalence regimes in other financial sectors (e.g., central clearing of derivatives), where equivalence entails recognising and accepting another jurisdiction's regulatory framework as a substitute for EU legislation.

This is not to suggest that the AIFMD entirely excludes coordination with third country rules. Equivalence assessments conducted by ESMA may also operate, albeit in a limited way, as a mechanism to ease potential regulatory conflicts. Where non-EU AIFMs or AIFs face incompatibilities between AIFMD requirements and their home-country regulations, exemptions from compliance with certain provisions of the AIFMD may be granted, provided that ESMA has confirmed the existence of equivalent rules under the relevant

³⁷⁷ Oliver Wyman, *The Impact of the UK's Exit from the EU on the UK-Based Financial Services Sector* (Oliver Wyman 2016) 2.

third country framework.³⁷⁸ In such cases, an equivalence assessment is required: if compliance with the AIFMD conflicts with other regulations, the non-EU AIFM must demonstrate that it is subject to equivalent regulatory provisions in the third country. These provisions must serve the same regulatory objectives, provide the same level of investor protection and be fully adhered to by the non-EU AIFM.³⁷⁹

4.4.5 The European Securities and Markets Authority's Role in the Third Country Regime Under the Alternative Investment Fund Managers Directive

The early version of the AIFMD third country access regime was much simpler, but its simplicity came at the cost of transferring the authority to authorise third country entities to ESMA. However, many Member States were unwilling to accept such a transfer of power, leading to the failure of this model.³⁸⁰ The Alternative Investment Fund Managers Directive retains significant operational authority over the regime. It has the power to conduct peer reviews of the authorisation and supervision of non-EU AIFMs within the European Union.³⁸¹ Additionally, if a national regulator believes that an authorised non-EU AIFM has breached its obligations under the Directive, it is required to notify ESMA.³⁸²

The ESMA has also been conferred with specific powers in relation to the third country aspects of the AIFMD and is empowered to request EU NCAs to take three forms of action: ESMA can (1) request NCAs to prohibit the marketing of AIFs managed by non-EU AIFMs and of non-EU AIFs by EU AIFMs where the passporting requirements have not been met; (2) impose restrictions on non-EU AIFMs relating to the management of an AIF in the case of an excessive concentration of risk in a specific market on a cross-border basis; and (3) impose restrictions on non-EU AIFMs relating to the management of an AIF where its activities potentially constitute an important source of counterparty risk to a credit institution or other systemically relevant institution.³⁸³ Although the execution of these powers is subject to strict limitations and can only be triggered under specific

³⁷⁸ Article 37(2) AIFMD; see also C Schmies, 'Commentary to AIFMD' in M Lehmann and C Kumpan (eds) *European Financial Services Law* (Nomos Verlagsgesellschaft 2019).

³⁷⁹ Christian Schmies, 'Third Country Relations and the Equivalence Regime: Treatment of Collective Investment Schemes' (2024) 25 *European Business Organization Law Review*.

³⁸⁰ Mirzha J De Manuel Aramendía, 'Third Country Rules for Alternative Investments: Passport Flexibility Comes at a Price' *ECMI Commentary No. 27/16*, December 2010 <<https://aei.pitt.edu/15462/>>

³⁸¹ Article 38 AIFMD.

³⁸² Article 46(3) AIFMD.

³⁸³ Article 47(4) AIFMD.

circumstances³⁸⁴ and ESMA has discretion over whether to exercise these direct intervention powers, they remain highly sensitive. This is because such powers involve EU agencies intervening in the market jurisdiction of Member State NCAs.

The ESMA is also responsible for coordinating the co-operation agreements required for negotiations with third countries, including those needed for cross-border supervision of AIFM delegates and depositaries. However, these agreements are bilaterally implemented by the national regulators and third country authorities involved.³⁸⁵

4.4.6 Extended Passport System with Equivalence Provisions: Centralising Power at the European Union Level

The 2011 AIFMD exports the European Union's approach to AIFM regulation through various channels and is associated with the tightening of AIFM regulation outside the European Union. This is because third country AIFMs and AIFs seeking access to the European Union must comply with the EU regime.³⁸⁶

The AIFMD envisions that, at least in the initial stages, NPPRs will continue to coexist with the introduction of the third country passport. According to Article 68(6) of the AIFMD, these passports can remain in place until the date specified in the delegated act that activates the third country passport. Once the third country passport is activated, NPPRs will eventually be phased out.³⁸⁷ However, owing to political and technical constraints on implementing the passport mechanism, NPPRs remain an important tool for non-EU managers seeking access to the EU market in the short term.

If the European Union ultimately decides to activate the AIFMD passport system, the authority for non-EU AIFs/AIFMs to access the European Union will be centralised at the EU level, requiring third country funds and fund managers to comply fully with the AIFMD. This requirement will also be established at the EU level. The possibility for

³⁸⁴ Article 47(5) AIFMD.

³⁸⁵ For example, ESMA press release 30 March 2013 (ESMA/2013/629) ESMA, on behalf of NCAs of the EU Member States, as well as Croatia, Iceland, Liechtenstein and Norway, negotiated co-operation arrangements with 34 counterparts worldwide (these arrangements have been effective since July 2013).

³⁸⁶ For example, *ibid.*

³⁸⁶ Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn Oxford University Press 2014) 307.

³⁸⁷ Article 68(6) AIFMD.

Member States to negotiate co-operation agreements with third countries at the national level will be eliminated, and the AIFMD will exert a strong and stringent regulatory influence beyond the European Union's borders.

The passport system embedded within the AIFMD reflects the EU Council and Commission's pursuit of further harmonisation within the European Union's legal and regulatory framework. Once the passport system is activated, Member States' discretion will be transferred to EU-level institutions, thereby further advancing regulatory uniformity across the pan-European fund industry. This ensures that EU AIFs/AIFMs and non-EU AIFs/AIFMs operate and compete under the same legal framework.

As a counterbalance to such a strong assertion, the AIFMD makes certain concessions: even if the AIFMD passport system is activated, the authorising authority for non-EU AIFMs remains the regulator of the AIFM's MSR. This means that Member States retain the authority to authorise non-EU AIFMs/AIFs and maintain their daily supervisory and regulatory functions. Compared to practices in other financial sectors, this is unusual, as in many other areas such authority is typically transferred to ESMA; the EU-level technical bureaucratic body. Therefore, retaining authorisation and daily regulatory powers at the Member State level can be seen as a mitigating measure by the European Union.

Nevertheless, opposition from Member States and other jurisdictions is entirely foreseeable. For third countries, the AIFMD introduces such strong and intrusive measures to exert its extraterritorial regulatory influence. Additionally, the option for EU Member States and third countries to coordinate and reach bilateral co-operation agreements will be removed, resulting in a significant loss of flexibility in collaboration for the fund industry.³⁸⁸

In November 2021, the European Commission submitted a proposal to amend the AIFMD (i.e., AIFMD II).³⁸⁹ However, AIFMD II does not significantly change the third country regime, and whether and when the third country passport will be activated remains to be seen.

³⁸⁸ Argument see, for example. Deutscher Bundestag Gesetzesentwurf der Bundesregierung, Entwurf eines Gesetzes zur Umsetzung der Richtlinie 2011/61/EU über die Verwalter alternativer Investmentfonds (AIFM-Umsetzungsgesetz – AIFM-UmsG), 6 February 2013 280.

³⁸⁹ Final version available at <https://data.consilium.europa.eu/doc/document/PE-67-2023-INIT/en/pdf>

4.5 Equivalence Regime in the European Union Insurance Sector: Solvency II Directive

Solvency II is a comprehensive regulatory framework established by the European Union for insurance and reinsurance companies. It aims to enhance the stability of the insurance industry, protect policyholders' interests, and promote transparency and efficiency among insurers. Solvency II applies to all insurance and reinsurance companies within the European Union but provides Exemptions³⁹⁰ or Simplified Obligations³⁹¹ for qualified smaller companies. The Solvency II framework is built around a Three Pillars structure, encompassing (1) capital requirements, (2) risk management and (3) disclosure obligations.³⁹²

The European Commission has been responsible for drafting the Solvency II Directive, establishing implementing measures and assessing its execution. Similar to the role of ESMA in securities regulation, the European Insurance and Occupational Pensions Authority (hereinafter EIOPA), established in January 2011, replaced the Committee of European Insurance and Occupational Pensions Supervisors (hereinafter CEIOPS) as the primary technical and bureaucratic authority in the insurance sector. This change was part of broader reforms to the European financial services regulatory framework. The European Insurance and Occupational Pensions Authority holds greater legislative authority than CEIOPS and continues to serve as a regulatory advisory body to the European Commission on Solvency II.

Solvency II was initially adopted in 2009, but its full implementation required detailed technical specifications and transitional rules. The Omnibus II Directive provided the final legal and technical details necessary for the implementation of the EU insurance regulatory framework.³⁹³ It not only paved the way for the comprehensive rollout of Solvency II, but

³⁹⁰ Article 4 of Solvency II Directive.

³⁹¹ Article 13 of Delegated Regulation (EU) 2015/35.

³⁹² Directive 2009/138/EC of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) [2009] OJ L335/1..

³⁹³ Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No. 1094/2010 and (EU) No. 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and European Supervisory Authority (European Securities and Markets Authority) [2014] OJ L153/1

also introduced significant adjustments and mechanisms to address the dynamic changes in the insurance industry and emerging risk management needs.

In the process of helping transform Solvency II from a theoretical framework into an operational legal system, the Omnibus II Directive granted EIOPA increased powers:³⁹⁴

- (a) *Development of Technical Standards:* EIOPA was authorised to draft binding RTS and ITS to ensure the consistent implementation of Solvency II across the European Union.

Supervisory Powers: EIOPA's ability to coordinate cross-border insurance groups was strengthened and it was granted direct intervention powers in certain exceptional circumstances.

Solvency II recognises the global nature of the insurance industry. In response, the Omnibus II Directive refined the provisions on the equivalence of third country regulatory frameworks under Solvency II, clarifying the assessment standards and procedures to ensure regulatory coordination between the EU and non-EU countries. The equivalence assessments promote an open international insurance market while ensuring that policyholders are adequately protected on a global scale.³⁹⁵

European Union law empowers EIOPA to assist the European Commission in preparing equivalence decisions related to third country regulatory regimes. Similar to the responsibilities held by ESMA, the equivalence regime under Solvency II also grants EIOPA the authority to conduct ongoing monitoring of third country regulatory frameworks. This involves assessing whether the implementation of third country regulatory rules and any potential amendments continue to meet the equivalence standards.

The equivalence regime under the Solvency II framework consists of the three modules illustrated in Figure 4.1:

³⁹⁴ Directive 2014/51/EU (Omnibus II), Article 10 and Article 15.

³⁹⁵ European Insurance and Occupational Pensions Authority
<https://www.eiopa.europa.eu/browse/regulation-and-policy/international-relations-and-equivalence_en>

Types of equivalence

There are three types of equivalence under Solvency II for the three areas mentioned above, with the following characteristics:

Full equivalence	Temporary equivalence	Provisional equivalence
Can be determined for all 3 areas	Can be determined (if progress is being made towards full equivalence) for reinsurance (Art. 172.4) and third country groups operating in the EEA (Art. 260.5)	Can be determined (if progress is being made towards full equivalence) for EEA groups operating in the third jurisdiction (Art. 227.5)
For unlimited period	For limited period (until 31/12/2020 with the possibility to extend by 1 year)	For limited period (10 years, renewable for further 10-year period)

Source: EIOPA official website³⁹⁶

Key: Art. = Article, EEA = European Economic Area

Figure 4.1: Types of equivalence under Solvency II

4.5.1 Reinsurance

The core function of reinsurance³⁹⁷ is to diversify and transfer risks, enabling the redistribution of risks on a global scale. Through the sharing and transfer of risks, a highly interconnected global risk management system is established. Furthermore, today's international reinsurance market is dominated by a few large reinsurance groups, many of which are not necessarily based within the European Union. Therefore, even if an insurance company operates strictly within a single jurisdiction within the European Union, it may still encounter issues related to Solvency II equivalence regime. This is due to reinsurance arrangements with non-European reinsurance entities, which may or may not be located within jurisdictions deemed equivalent under Solvency II. Establishing an equivalence regime for the international business activity of reinsurance helps the EU

³⁹⁶ European Insurance and Occupational Pensions Authority (EIOPA), 'International Relations and Equivalence' <https://www.eiopa.europa.eu/browse/regulation-and-policy/international-relations-and-equivalence_en>

³⁹⁷ European Insurance and Occupational Pensions Authority (EIOPA), 'International Relations and Equivalence' https://www.eiopa.europa.eu/browse/regulation-and-policy/international-relations-and-equivalence_en accessed 26 August 2025. Also see Article 172 of the Solvency II Directive.

insurance industry engage in global risk pooling and commercial operations while maintaining its competitiveness in the international market.

The solvency calculation for reinsurance³⁹⁸ is the process by which insurance companies incorporate the risk-mitigating effects of reinsurance contracts into their capital requirements when assessing their financial soundness and capital adequacy. This is a key component of the Solvency II framework, designed to ensure that insurance companies can withstand potential risks and meet solvency requirements, while also recognising the role of reinsurance as a risk management tool. Solvency II stipulates that EU insurance companies can treat reinsurance contracts signed with reinsurers as a risk-mitigating technique when calculating the Solvency Capital Requirement. This means that reinsurance contracts can help reduce the capital requirements for EU insurance companies, as part of the risk has been transferred to the reinsurer.

Equivalence in reinsurance allows EU insurance companies to treat reinsurance contracts from these countries as risk mitigation measures and include them in solvency calculations without the need for additional capital reserves. Conversely, if a third country where the reinsurer is based is not deemed equivalent, EU insurance companies must bear a higher capital charge when using reinsurance contracts from such companies to mitigate capital requirements. This reflects the potential additional credit or regulatory risks associated with these contracts. When a reinsurance company is based in a non-EU country that has been deemed equivalent, EU insurance companies can directly include contracts with that reinsurer in their solvency assessments. As a result, EU insurers are more likely to collaborate with reinsurers from equivalent countries, as working with these companies reduces their capital burden. At the same time, this may lead to third country reinsurers without equivalence losing their competitive edge in the EU market.

- (a) To achieve reinsurance equivalence, the regulatory framework of a non-EU country must meet the following key criteria:³⁹⁹

³⁹⁸ The goal of solvency calculation is to assess whether an insurance company has sufficient capital to handle potential risks, including underwriting risk, market risk, credit risk and operational risk. In this context, the primary role of reinsurance is to help insurance companies diversify underwriting risks, thereby reducing their risk exposure.

³⁹⁹ Article 172 of the Solvency II Directive outlines the equivalence assessment criteria for reinsurance companies entering the EU market from third countries. At the same time, the Solvency II Directive provides specific equivalence assessment standards and guidelines in Annex II, ensuring that the regulatory framework of third countries is aligned with the core principles of Solvency II.

- (b) *Capital requirements:* Reinsurance companies must maintain sufficient capital reserves to support their underwriting risks, comparable to the requirements under the Solvency II framework.
- (c) *Financial stability:* Non-EU countries must rigorously monitor the solvency and financial condition of their reinsurance companies.
- (d) *Regulatory transparency:* The regulatory authorities in the country must demonstrate a high level of transparency, and be able to share critical data and information with EU regulators.

Contract enforceability: The terms and conditions of reinsurance contracts must be legally enforceable and reliably upheld in the relevant jurisdiction.

Insurance companies must clearly disclose how reinsurance contracts affect their capital requirements. Only reinsurance contracts that meet Solvency II standards – including the legal enforceability of the contracts and the qualifications of the reinsurer – can be considered valid risk mitigation tools. If a reinsurer is based in a non-EU country, the regulatory framework of that country must be recognised as equivalent by the European Union to qualify for preferential capital treatment.

While the principle of equivalence under Solvency II does not directly grant market access to third country insurance or reinsurance undertakings, it is closely tied to market access. This is because it ensures that third country reinsurers can provide meaningful reinsurance coverage to insurance and reinsurance companies within the European Economic Area (hereinafter EEA);⁴⁰⁰ in other words, in terms of market competitiveness, reinsurers from jurisdictions that have achieved equivalence recognition will clearly gain a competitive advantage in the EU market. This indirectly enhances the ease with which third country reinsurers can access the EU market.

It is worth noting that EIOPA recently published a consultation paper on the regulation of reinsurance agreements with third country insurance and reinsurance undertakings.⁴⁰¹ From this paper, it is evident that EIOPA expects insurance undertakings to assess their intended reinsurance arrangements from multiple perspectives appropriately, including evaluating

⁴⁰⁰ Article 172(3) Solvency II Directive.

⁴⁰¹ European Insurance and Occupational Pensions Authority (EIOPA), Consultation Paper on Supervisory Statement on Supervision of Reinsurance Concluded with Third Country Insurance and Reinsurance Undertakings (EIOPA-BoS-23/145, 10 July 2023).

third country environment-related risks, such as the legal environment. The consultation paper specifically highlights legal/compliance risks related to third countries, including risks arising from international sanctions and third-party risks. While this guidance-focused consultation paper is unrelated to equivalence assessments, it does indicate that equivalence effectively exempts insurance undertakings from considering certain aspects of a third country's legal environment, such as its bankruptcy legislation.⁴⁰² This will reduce the compliance costs EU companies need to bear when diversifying risks through reinsurance contracts with third countries.

4.5.2 Solvency Calculation Requirements

- (i) The solvency capital requirements under Solvency II⁴⁰³ are divided into two tiers:
- (ii) *Minimum capital requirement (hereinafter MCR)*:⁴⁰⁴ The minimum level of capital that insurance companies must maintain to avoid the risk of insolvency

Solvency capital requirement (hereinafter SCR):⁴⁰⁵ A dynamic capital level set based on quantifiable risks (e.g., underwriting risk, market risk and credit risk), designed to ensure that insurance companies can withstand severe but foreseeable losses.

If the capital rules of a non-EU country are recognised as equivalent, EU insurance groups' subsidiaries in those countries can comply with local capital requirements as a substitute, without the need to fully recalculate according to Solvency II. However, for non-EU insurance groups, if the home country of the non-EU parent company is deemed equivalent in terms of capital calculations, its branches or subsidiaries in the European Union can use the capital calculation rules of their home country without recalculating capital requirements under Solvency II.

European Union regulatory authorities (i.e., EIOPA) assess the equivalence of non-EU countries' capital requirement regimes based on the following criteria.⁴⁰⁶

⁴⁰² Arthur van den Hurk, 'Equivalence and Insurance' (29 January 2024) 25 Eur Bus Org Law Rev 209–228 <<https://doi.org/10.1007/s40804-023-00308-z>>

⁴⁰³ Article 227 Solvency II Directive.

⁴⁰⁴ Article 129 Solvency II Directive.

⁴⁰⁵ Article 100 Solvency II Directive.

⁴⁰⁶ Article 227 of the Solvency II Directive. Annex VI also provides specific equivalence assessment standards and guidelines, ensuring that the regulatory framework of third countries aligns with the core principles of Solvency II.

- (a) *Risk orientation*: The capital calculation in the non-EU country must be based on risk exposures and cover major risk categories similar to those under the Solvency II framework
- (b) *Capital adequacy*: Local regulatory rules must ensure that insurance companies hold sufficient capital to withstand significant risks
- (c) *Regulatory transparency*: The non-EU country's regulatory regime must be clear, operational and capable of interfacing with the EU framework

Principles of prudential supervision: Local regulation must focus on protecting policyholders' interests and ensuring the stability of the market.

4.5.3 Group Supervision

In addition to prudential supervision of insurance and reinsurance activities licensed within the EEA at the individual level, groups with business structures that include EEA insurance or reinsurance branches are also subject to Solvency II group supervision⁴⁰⁷.

Insurance groups typically operate across multiple jurisdictions, undergoing prudential supervision at the level of individual licensed insurance or reinsurance entities, while also being subject to supplemental group-level supervision under the EU Solvency II framework. Regulatory challenges arise when these groups have entities outside the EU internal market (e.g., through subsidiaries or parent companies) or provide products to insurance or reinsurance entities within the EU internal market. The equivalence of group supervision aims to streamline regulatory coordination for multinational insurance groups, enhancing the efficiency and stability of the international insurance market.

When the parent company of a multinational insurance group is based in a non-EU country and its subsidiaries or branches operate within the European Union, the equivalence regime can prevent EU regulators from requiring additional Solvency II-based assessments of the entire group. As long as the parent company's home country is deemed equivalent in terms of supervision, EU regulators will accept the group supervision conducted by that country

⁴⁰⁷ Article 260 Solvency II Directive.

without the need for further regulatory evaluation of the group. For groups that include EEA insurance or reinsurance branches, obtaining equivalence recognition for group supervision reduces compliance burdens, simplifies capital management and lowers the cost of entering the EU market.

To achieve equivalence of group supervision, the regulatory framework of a non-EU country must meet the following core standards:⁴⁰⁸

- (a) *Solvency requirements*: The framework must ensure that the group has sufficient capital to withstand risks, similar to Solvency II standards
- (b) *Regulatory consistency*: The system must include effective group supervision mechanisms, covering areas such as risk assessment and capital adequacy monitoring

Transparency and information sharing: Non-EU regulatory authorities must maintain open and timely communication with EU regulators.

The purpose of equivalence of group supervision is to streamline regulation by focusing on the holistic management of multinational groups and reducing day-to-day intervention in their operational models. Once equivalence is granted, the European Union will rely on the supervision and information-sharing mechanisms of the third country regulator for the daily management of the insurance group, thereby reducing compliance costs associated with duplicate supervision. However, this does not imply a relaxation of requirements for compliance at the individual business level. For example, US insurance groups operating in the European Union can follow US regulatory rules for their daily operations, avoiding duplicate supervision. However, if a US group transfers its reinsurance arrangements to China and China has not been granted equivalence recognition for reinsurance, those reinsurance contracts cannot be considered valid risk mitigation tools in the capital calculations of EU insurance companies. Consequently, they would still be subject to additional capital requirements.

⁴⁰⁸ Article 260 of the Solvency II Directive addresses the issue of equivalence for group supervision, specifying that the equivalence of a third country regulatory framework can apply to group-level supervision and capital requirement assessments. Additionally, it is necessary to refer to Annex VI, which provides more specific equivalence assessment standards and guidelines.

The key differences among the three regimes are shown in Table 4.2:

Table 4.2: Equivalence in three areas under the Solvency II regime

Equivalence type	Objective	Scope of impact	Applicable entities	Primary beneficiaries
Group supervision equivalence	Simplify cross-border group supervision coordination	Supervision of entire cross-border insurance groups	European Union regulators and third country regulators	Cross-border insurance groups
Reinsurance equivalence	Promote co-operation between European Union insurers and third country reinsurers	Risk mitigation of reinsurance contracts	European Union insurance companies and third country reinsurers	EU insurance companies and third country reinsurers
Solvency capital requirement calculation equivalence	Simplify capital calculation methods for third country insurers	Capital calculation for individual insurance companies	Third country insurers wishing to enter the European Union market	Third country insurers

The three different equivalence regimes focus on distinct aspects and have varying technical approaches during the assessment process. What they share in common is the inclusion of transparency requirements, which mandate that non-EU regulatory authorities maintain open and timely information exchanges with EU regulators. In addition, Articles 378 and 380 of Delegated Regulation (EU) 2015/35 further specify detailed standards regarding equivalence for reinsurance activities and group supervision.

After analysing and exploring the three different equivalence regimes under Solvency II, the conclusion could be reached that the equivalence regime in Solvency II does not directly address the possibility of third country companies entering the European Union and conducting business operations; in other words, it does not focus on market access. Instead, Solvency II emphasises solvency assessment and capital requirements. Its core

objective is to evaluate and ensure the risk-bearing capacity of insurance and reinsurance companies. The regime focuses on whether the regulatory framework of a third country can provide a level of risk management and capital adequacy comparable to the EU Solvency II framework. It does not directly determine whether third country companies can access the EU market, but rather creates a more flexible and coordinated regulatory environment for those third countries that are deemed equivalent.

4.6 Conclusion

In this chapter it was shown that the application of the EU equivalence regime outside the core areas of clearing and trading follows a markedly different trajectory. In sectors such as issuer disclosure, CRAs, funds and insurance, equivalence has been less frequently used, more fragmented in design and often left in the hands of national authorities. Unlike the centralised frameworks under EMIR and MiFIR, where equivalence has supported the consolidation of supervisory power and the construction of the Single Rulebook, here equivalence operates as a supplementary or prudential device rather than a central market-access instrument.

The key difference lies in the nature of these markets. They are closely connected to the retail segment, where consumers are highly vulnerable to misconduct, mis-selling and market failures. For this reason, equivalence has been weak or almost absent in retail-facing sectors: strong consumer protection imperatives, combined with divergent national preferences and entrenched domestic interests, have prevented a rapid move towards EU-level centralisation. In the fund industry, UCITS remains strictly domestic in orientation, while the AIFMD third country passport has never been activated. In insurance, Solvency II equivalence is narrowly prudential, concerned with solvency calculations, group supervision and reinsurance rather than liberalising cross-border consumer products. Only in the case of CARs did the EU employ equivalence more actively, both to counterbalance US dominance and to stimulate its own industry.

Taken together, these developments highlight the selective and differentiated nature of equivalence. In retail-linked sectors, fragmentation, consumer protection concerns and national discretion dominate, constraining the supranational use of the instrument. At the same time, the examples illustrate that equivalence can serve different purposes: it may

function as a prudential safeguard, as an industrial policy tool or as a defensive response to external market power. The variation across sectors reinforces the broader point that equivalence is not a uniform legal instrument but a governance technique whose form and intensity are shaped by the political economy of integration and the specific vulnerabilities of each market domain.

CHAPTER 5: THREE FUNCTIONAL MODELS OF THE EUROPEAN UNION EQUIVALENCE REGIME: STRUCTURED DIFFERENTIATION IN PRACTICE

5.1 Introduction

As demonstrated in Chapter 2, the European Union equivalence regime is often presented as a technical mechanism for assessing whether the legal and supervisory framework of a third country achieves outcomes comparable to those required under European Union law. Typically, the European Commission evaluates whether the relevant third-country (1) has legally binding requirements, (2) ensures effective supervision by competent authorities and (3) achieves results equivalent to the corresponding EU rules⁴⁰⁹.

From a technical standpoint, the equivalence mechanism is expected to apply a stable benchmark based on the European Union's own regulatory framework and substantive regulatory outcomes, providing an objective and neutral assessment of third country regimes. In practice, however, the selective and differentiated standards observed in implementation suggest that the European Union does not apply the same degree of openness, the same intensity of scrutiny, or the same institutional expectations equally to all applicant jurisdictions. Some jurisdictions are treated as trusted partners whose regulatory alignment can be incorporated into the European Union's broader supervisory order. Others are approached with caution, granted only limited or temporary recognition, or denied equivalence altogether. In still other cases, equivalence becomes the object of prolonged bilateral negotiation between regulatory powers of comparable weight. The external operation of the regime therefore displays a structured differentiation that cannot be explained merely by reference to the formal legal design of equivalence provisions.

This chapter argues that the European Union equivalence regime has crystallised in practice into three functional models: an integrationist model, a defensive model, and a negotiationist model. The central aim of this chapter is to identify these recurring forms

⁴⁰⁹ European Commission, 'Equivalence of Non-EU Financial Frameworks' (European Commission, 13 July 2023) <<https://finance.ec.europa.eu/eu-and-world/equivalence-non-eu-financial-frameworks-en>>

and to show that equivalence functions not simply as a technical market-access device, but as a differentiated mode of external financial governance.

Within the three functioning models, the underlying and recurring drivers may be grouped into two broad categories. The first is financial stability, understood as a structural constraint on the European Union's external regulatory choices as mentioned in Chapter 2. The second is regulatory power projection, understood as the European Union's effort to preserve its own regulatory autonomy, manage competitive threats, and extend the influence of its regulatory model beyond its borders. These two categories, comprising four more specific strands, combine in different proportions and configurations, thereby producing different modes of governance across different jurisdictions. Much like the same basic ingredients can be mixed into potions with different effects, the same underlying drivers can generate distinct regulatory patterns depending on the context in which they are mobilised. The value of the three-model framework lies precisely in making those patterns visible, while the analysis of the underlying drivers explains why they recur in the specific forms identified here.

Put simply, where a third country is willing and proactive in accepting the European Union's regulatory preferences and in treating the EU framework as a reference point for its own domestic regulatory development, equivalence is more likely to operate in an integrationist manner. The integrationist model is not a single fixed pattern, but rather as a spectrum ranging from high-intensity to low-intensity forms of convergence-oriented equivalence. Compared with more peripheral jurisdictions, third countries that are more closely embedded in the EU single market are likely to be subject to stronger expectations of regulatory alignment and a higher degree of convergence. Where the third country combines high systemic importance with strong competitive pressure and the prospect of future divergence, equivalence tends to function defensivel, under which access is managed selectively, dependence is tolerated only where necessary, and policy is oriented towards gradual disentanglement. Where the third country is itself a powerful rule-maker with substantial market leverage so that equivalence cannot simply be imposed or withheld unilaterally, it becomes the subject of bargaining, technical accommodation and reciprocal adjustment. In such cases, equivalence functions in a negotiationist manner.

This chapter proceeds as follows. Section 5.2 sets out the analytical framework by identifying the two structural drivers that shape the differentiated operation of the equivalence regime and by defining the three functional models. Sections 5.3, 5.4 and 5.5 then examine, respectively, an integrationist model (Switzerland and peripheral jurisdictions), a defensive model (the United Kingdom), and a negotiationist model (the United States). Each is explored through the jurisdiction or jurisdictions that provide the clearest case study of the model in practice. Section 5.6 draws the comparative threads together and shows that the differentiated operation of equivalence is neither arbitrary nor incidental, but reflects a structurally patterned mode of strategic governance. Section 5.7 concludes the chapter.

5.2 Analytical Framework: From Policy Drivers to Functional Models

5.2.1 Financial Stability as a Structural Constraint

The first structural driver is financial stability. As argued in earlier chapters, the post-crisis development of European Union financial regulation has elevated financial stability from a secondary prudential concern into an overarching objective capable of reshaping legislative design, supervisory practice and judicial reasoning. In the context of equivalence, this transformation matters because equivalence is more like a risk-management instrument through which the European Union decides when, and on what terms, regulatory reliance on third-country frameworks is institutionally tolerable.

This stability logic introduces differentiation according to the nature of the financial activity concerned and the degree of structural dependence involved. In sectors of systemic importance, its implications depend on the degree of structural dependence involved. Where a systemically important activity can be internalised within the European Union without causing significant market disruption, financial stability may support a more restrictive approach, including relocation requirements, direct supervision, or the refusal of equivalence. By contrast, where the sector is systemically important but the European Union remains structurally dependent on third-country infrastructures or services (like central clearing services), financial stability may instead require a more accommodating or transitional approach, since abrupt exclusion could itself generate systemic risk. Outside these systemically important sectors, however, the rationale is different. In other areas

where the European Union grants market access through equivalence, financial stability remains a background prudential condition, but it is usually not the decisive consideration. In areas like accounting rules and risk-weight exposure calculation, equivalence operates more as a conditional market access technique, allowing the European Union to reduce duplicative regulation, manage cross-border participation, and preserve regulatory control while admitting third-country actors in areas where the risks of dependence are less acute.

Financial stability therefore operates as a structural constraint. It helps explain why the European Union may be relatively open in one sector yet highly restrictive in another, even towards the same third country. It also explains why equivalence has increasingly been coupled with monitoring, review, withdrawal clauses and enhanced supervisory powers because these mechanisms enable the European Union to manage dependence without relinquishing control.

5.2.2 Regulatory Power Projection: Autonomy, Competition and External Influence

The second structural driver is regulatory power projection. Equivalence is formally framed in the language of comparability and prudential outcomes, but in practice it also operates as a mechanism through which the European Union protects its own regulatory autonomy, manages competitive threats, and projects its regulatory preferences outward. Market access to the European Union carries significant value. That value allows the European Union to encourage, induce or pressure third countries to align domestic regulatory frameworks with European Union expectations.

This external dimension is particularly visible in two settings. The first is the European Union's interaction with major regulatory powers, especially where the third country possesses a sophisticated financial centre and an independent capacity to shape international standards. In that context, regulatory power projection is expressed primarily through the management of regulatory competition and the protection of the European Union's own regulatory autonomy, including the European Union's concern to preserve the integrity of its internal rulebook, prevent external undercutting, and ensure that third-country access does not weaken the European Union's own supervisory architecture. The second is the European Union's relationship with low-risk or peripheral jurisdictions,

where the attraction of access to the European market may encourage regulatory convergence towards the EU model. In those contexts, regulatory power projection operates more through the outward extension of the European Union's normative and institutional influence beyond its territorial borders.

This dynamic is particularly visible in the European Union's relations with other major regulatory powers. Where the third country possesses a sophisticated financial centre, strong domestic regulatory institutions, and an independent capacity to influence international standards, equivalence is not simply a technical exercise. It becomes bound up with the management of regulatory competition and the preservation of the European Union's own regulatory autonomy. In such contexts, the EU is not merely assessing whether foreign rules are functionally comparable. It is also deciding whether third-country access might undermine the integrity of its internal supervisory framework, permit external undercutting of EU standards, or weaken the Union's capacity to regulate its own market on its own terms. Here, regulatory power projection takes on a defensive character: equivalence becomes a means through which the European Union resists being displaced by rival regulatory centres and protects the institutional and normative integrity of its own regime.

The same driver appears differently in relation to low-risk or peripheral jurisdictions. In those cases, the issue is usually not direct regulatory rivalry with a peer competitor, but the outward diffusion of EU rules and regulatory expectations. For jurisdictions whose financial actors value access to the EU market, equivalence creates incentives to align domestic frameworks with the Union's requirements. The EU rulebook thus functions not only as an internal framework of harmonisation, but also as an external regulatory template. In this setting, equivalence operates as a mechanism of rule export: it encourages third countries to adapt their domestic systems in ways that make them more legible and acceptable to the European Union, thereby extending the Union's normative and institutional influence beyond its formal territorial boundaries. This reflects the broader point that influence in international financial governance depends not only on market size, but also on regulatory capacity, since the ability to define the conditions of market access is itself a form of regulatory power⁴¹⁰.

⁴¹⁰ See, eg, Lucia Quaglia, *The European Union and Global Financial Regulation* (Oxford University Press

Accordingly, regulatory power projection should not be understood as a single, uniform logic. It contains at least two distinct but related dimensions. In one dimension, it is expressed through the defence of regulatory autonomy and the management of competition vis-à-vis other major powers. In the other, it is expressed through the outward projection of EU rules and institutional expectations towards smaller or more peripheral jurisdictions. These dimensions do not displace the financial stability rationale discussed above, but operate alongside it. Their relative weight varies across sectors and jurisdictions, and it is precisely this variation that helps explain why the equivalence regime takes different functional forms in practice. In the case studies that follow, this driver is shown to operate differently across the three models: as intensified alignment in the integrationist model, as a defensive response to competitive and institutional threats in the defensive model, and as a negotiated form of regulatory interaction in the negotiationist model.

5.2.3 Three Functional Models of Equivalence

When these two drivers are combined, three functional models can be identified.

First, the integrationist model describes situations in which equivalence is used to incorporate a third country into a broader European Union-centred regulatory order. This model tends to arise where regulatory rivalry is limited, convergence is high, and the third country is prepared to align with European Union expectations over time. Equivalence in this setting is comparatively permissive and trust-based, even though it may still remain formally unilateral.

Secondly, the defensive model describes situations in which equivalence is used to manage exposure to a strategically sensitive third country that is both systemically relevant and competitively threatening. In this model, the European Union does not simply open or close access in a uniform way. Instead, it differentiates across sectors according to dependence. Where dependence is low, exclusion is possible. Where dependence is high, equivalence may be granted, but only conditionally, temporarily, and alongside efforts to

2014); See also Ian Manners, 'Normative Power Europe: A Contradiction in Terms?' (2002) 40 *Journal of Common Market Studies* 235, arguing that the European Union exerts influence through both 'what it is' and 'what it does'.

reduce long-term reliance. Equivalence thus functions as a buffer and containment strategy rather than as a pathway to integration.

Thirdly, the negotiationist model describes situations in which equivalence becomes the object of bargaining between the European Union and another powerful regulatory actor. In this setting, the third country cannot be treated merely as a rule taker. Its own market importance, regulatory capacity and institutional leverage mean that equivalence is shaped through ongoing bilateral adjustment, technical negotiation and partial accommodation. Equivalence here is neither purely deferential nor simply defensive. It becomes an arena in which competing jurisdictions negotiate the terms of mutual toleration.

These models capture recurrent patterns in the operation of the European Union equivalence regime as analytical forms and their value lies in showing that the differentiated practice of equivalence is structured, intelligible and strategically patterned. The three functional models show how the same underlying political drivers can be combined in different proportions to generate distinct patterns of external governance. In each model, financial stability and regulatory power projection, including regulatory autonomy, market competition, and external rule influence, remain present, but their relative weight varies, producing different configurations of the regime.

The following sections examine the case studies associated with each of the three functional models. By examining how equivalence has been applied in relation to different third-country jurisdictions, it becomes possible to see more clearly how these models exist and operate in practice.

5.3 The Integrationist Model: Switzerland versus Peripheral Jurisdictions

The integrationist model arises where the equivalence regime is used primarily to draw third countries into an EU-shaped pattern of regulatory alignment rather than to contain them as competitive threats or bargain with them as regulatory peers. As mentioned before, the same underlying drivers remain relevant: the preservation of financial stability, the defence of EU regulatory autonomy, the management of market competition and the outward projection of the EU regulatory order. What distinguishes the integrationist model is the way in which these drivers are weighted and combined.

Within this configuration, the outward projection of EU regulatory influence is particularly strong. Equivalence serves as a mechanism through which the Union can shape the legislative, supervisory and market practices of third countries by making recognition conditional upon sufficient alignment with EU-defined standards. At the same time, the autonomy-defensive dimension remains comparatively weak. The jurisdictions concerned are not treated primarily as rival centres of regulatory power whose access must be strategically withheld or destabilised. Rather, they are approached as external jurisdictions that can, to differing degrees, be drawn into the Union's regulatory orbit.

Financial stability remains relevant within this model, but it does not have a uniform effect. Instead, it operates as a variable that affects the intensity with which integrationist equivalence is pursued. Where the third country is geographically proximate, financially significant, and more deeply embedded in the economic space surrounding the Union, financial stability concerns intensify the demand for close, durable and granular convergence. Where those concerns are more muted, the same integrationist logic can operate in a looser and more permissive form. The integrationist model should therefore be understood not as a single fixed pattern, but as a spectrum ranging from high-intensity to low-intensity forms of convergence-oriented equivalence.

Understood in this way, the integrationist model uses equivalence as an instrument of conditional incorporation. Within this model, third countries are positioned neither as equal co-authors of regulatory terms nor as jurisdictions to be excluded unless compelled by necessity. Recognition is instead structured to encourage, reward and stabilise convergence around the EU framework, drawing third countries into an EU-shaped pattern of regulatory alignment through conditional access.

The integrationist model itself contains internal intensity gradations. Some involve dense, highly structured and politically sensitive forms of approximation, while others involve looser and more permissive forms of alignment. In both instances, the regime is used to encourage third countries to move in step with the European Union and the difference lies in the degree of convergence expected, the granularity at which comparability is evaluated, and the extent to which equivalence becomes entangled with wider institutional governance.

First, there is variation in the granularity of convergence expected. At the higher-intensity end of the model, the practical meaning of equivalence moves closer to dense regulatory synchronisation. Although formal legal identity is not required, the third country is expected to maintain a close and continuing degree of alignment with EU rules, supervisory methods and institutional direction. At the lower-intensity end, by contrast, the Union is more willing to accept broader functional comparability and lower-granularity forms of alignment, so long as the relevant outcomes remain satisfactory from the perspective of market access and regulatory influence.

Second, the intensity of the integrationist model also varies according to how tightly equivalence is connected to an ongoing relationship of regulatory synchronisation with the European Union. In higher-intensity cases such as Switzerland, equivalence recognition is linked to the expectation of continuing alignment with the development of EU rules, supervisory expectations and, at times, broader institutional arrangements. In lower-intensity cases involving more peripheral jurisdictions, equivalence still encourages adaptation to EU standards, but without the same expectation of close and durable synchronisation with the wider movement of the EU framework.

Third, the intensity of the integrationist model varies according to the degree of financial risk and market significance perceived by the European Union. Where the third country is financially substantial, geographically proximate, or closely tied to markets relevant to EU stability, the Union has stronger reasons to demand robust and durable convergence. Where the jurisdiction is more peripheral, less systemically significant from the EU perspective, and less capable of generating competitive or stability-related pressures, the same integrationist logic can operate more permissively.

The result is a single model with distinct internal variants. Switzerland represents a high-intensity form of integrationist equivalence. Peripheral jurisdictions represent a lower-intensity form of the same model. Both are integrationist because both are organised around the outward projection of EU standards and the incorporation of third countries into an EU-shaped regulatory orbit. But they differ in the closeness, granularity and institutional density of the alignment expected.

5.3.1 Switzerland as a high-intensity integrationist variant

Although Switzerland is not a member of the European Economic Area, it still embedded within EU internal market via the European Free Trade Association. Official Swiss materials expressly state that Switzerland “participates in certain areas of the EU internal market”⁴¹¹, and its relationship with the European Union is governed by a complex network of bilateral sectoral agreements or treaties, the application and interpretation of which are managed through political and diplomatic mechanisms within the Switzerland–EU Joint Committee⁴¹². This unusually deep economic integration, combined with Switzerland's geographic proximity to the Union and its status as a major global financial centre, means that regulatory misalignment is capable of generating more immediate and more significant spillover effects for the functioning and security of the EU internal market than would be the case in more peripheral jurisdictions. For that reason, the European Union has stronger grounds to insist upon a denser and more reliable form of regulatory convergence in relation to Switzerland than it does elsewhere.

While the broader Switzerland–EU relationship is governed by a complex web of bilateral agreements, Switzerland is classified as a 'third country' under the European Union's financial services legislative framework, and the principles of free movement of capital and services that apply to EU Member States do not extend to Switzerland. Consequently, using equivalence as a market access mechanism remains a key component of Switzerland's broader objective to strengthen the competitiveness of its financial centre⁴¹³, and Switzerland has consistently sought to maintain a high degree of regulatory alignment with the European Union framework, actively adjusting its domestic regime to ensure convergence with the EU's single rulebook.

Switzerland therefore represents a high-intensity form of the integrationist model and equivalence operates as a mechanism for structuring the relationship through conditional incorporation, under which Switzerland is expected to maintain a sufficiently close and durable alignment with the EU regulatory framework. The objective is not merely to grant

⁴¹¹ Swiss Federal Council, Institutional elements (Factsheet, 13 March 2026) 1.

⁴¹² Swiss Federal Council, 'Content of the package Switzerland-EU (Bilaterals III)' (13 March 2026) <https://www.europa.eda.admin.ch/en/content-package-switzerland-eu> accessed 3 April 2026.

⁴¹³ Aline Darbellay, 'Third-country Regime and Equivalence: Swiss' (2024) 5 *European Business Organization Law Review* <<https://link.springer.com/article/10.1007/s40804-023-00307-0>>

market access, but to ensure that Switzerland's participation in relevant areas of the internal market remains embedded in a framework of ongoing legal and regulatory convergence, thereby supporting homogeneity of rules, legal certainty, and a level playing field over time⁴¹⁴.

5.3.1.1 Equivalence under the Solvency II Directive for Switzerland

The legal foundation for Switzerland's recognition as an equivalent third country under Solvency II is provided by Swiss legislation, including an ordinance adopted by the Federal Council in 2005, which came into effect in 2006. This ordinance established the legal basis for the Swiss Solvency Test (hereinafter SST) rules governing Swiss insurance companies⁴¹⁵. The ordinance granted authority to the Swiss Financial Market Authority (hereinafter FINMA) to refine the SST rules, particularly in developing regulations for solvency calculations. In accordance with the requirements of the ordinance, FINMA formulated and implemented the SST rules in 2011⁴¹⁶.

The ordinance underwent partial revisions in 2014, addressing solvency issues, qualitative risk management and disclosure requirements. These amendments were not only part of crisis-driven regulatory reforms, but also a response to the inconclusive equivalency assessment previously conducted by the European Insurance and Occupational Pensions Authority (hereinafter EIOPA) of Switzerland's insurance regulatory framework⁴¹⁷. It has been observed that the 2014 revisions to the ordinance were a significant factor leading to

⁴¹⁴ Although not concerned with equivalence as such, the EU's approach towards Switzerland has been to place Swiss participation in relevant internal market sectors on a more homogeneous, legally certain and level-playing-field basis. See generally European Commission, Recommendation for a Council Decision authorising the opening of negotiations between the European Union and the Swiss Confederation on institutional solutions for EU-Switzerland agreements related to the internal market, on agreements that form the basis for Switzerland's permanent contribution to the Union's cohesion and for Switzerland's association to Union programmes, COM(2023) 798 final, recitals 8–10, and annex, 1–2.

⁴¹⁵ See Der Schweizerische Bundesrat (Swiss Federal Council), Verordnung vom 9 November 2005 über die Beaufsichtigung von privaten Versicherungsunternehmen (Aufsichtsverordnung, AVO) SR 961.011 Insurance Supervisions Ordinance, Arts 41 and following <<https://www.fedlex.admin.ch/eli/cc/2005/735/de>>

⁴¹⁶ Der Schweizerische Bundesrat (Swiss Federal Council), Verordnung vom 9 November 2005 über die Beaufsichtigung von privaten Versicherungsunternehmen (Aufsichtsverordnung, AVO) SR 961.011 Insurance Supervisions Ordinance Art 216, para 4(d). The SST rules entered into force in 2011 (Aufsichtsverordnung Art 216, para 4(d)), five years after the ordinance entered into force.

⁴¹⁷ Federal Department of Finance, Teilrevision der Aufsichtsverordnung AVO: Erläuterungsbericht Revision of the Swiss Insurance Supervisions Ordinance Explanatory Report (Swiss Federal Department of Finance, 31 October 2014) <www.admin.ch/ch/d/gg/pc/documents/2628/AVO_Erl.-Bericht_de.pdf>

the European Union's decision in 2015 to grant equivalence recognition to the Swiss SST⁴¹⁸.

The legislation and regulations enacted by Switzerland prompted the European Commission to recognise it as an equivalent third country jurisdiction in 2015. Under the equivalence rules of the Solvency II Directive, this recognition allows Switzerland to conduct the prudential regulation and supervision of insurance companies in line with EU standards.

Article 260 of the Solvency II Directive concerns group supervision and is particularly relevant to Swiss insurance companies with subsidiaries in the European Union. Since Swiss regulations are recognised as equivalent in the area of group supervision, Swiss insurance groups headquartered in Switzerland that own or control subsidiaries based in the European Union can be exempt from group-level supervision by EU authorities. This exemption helps avoid duplicative regulatory and supervisory costs, leading to significant cost savings for Swiss insurance groups. Major Swiss insurers such as Zurich, Swiss Re, Swiss Life, Basler Versicherungen and Helvetia stand to benefit substantially from these cost reductions; for example, Switzerland's equivalence designation under Solvency II means that EU regulators cannot impose discriminatory regulatory requirements on reinsurance companies headquartered in Switzerland. This includes restrictions such as requiring them to hold deposits in the EU jurisdictions where they conduct business⁴¹⁹.

Under Article 172 of the Solvency II Directive, the same equivalence rules also apply to Swiss reinsurance companies. This is particularly important for major Swiss reinsurers with subsidiaries in the European Union, such as Swiss Re, SCOR Switzerland, New Re, Trans Re and Amlin. This equivalence designation means that EU regulators must treat Swiss reinsurers in the same manner as European Union-based reinsurers, ensuring a level playing field in terms of regulatory requirements.

⁴¹⁸ Swiss Financial Market Supervisory Authority (FINMA), 'EU Recognises Swiss Insurance Supervision as Equivalent' Press Release (Swiss Financial Market Supervisory Authority 5 June 2015) <www.finma.ch/de/news/2015/06/20150605-eu-anerkennt-schweizer-versicherungsaufsicht-als-gleichwertig/>

⁴¹⁹ Kern Alexander, 'The UK's Third-country Status Following Brexit: Post-Brexit Models, Third-Country Equivalence and Switzerland' in Kern Alexander et al, *Brexit and Financial Services: Law and Policy* (Hart Publishing, 2018)

The equivalence decision will simplify the operations of Swiss insurance and reinsurance groups within the European Union. It allows them to calculate solvency ratios and meet other prudential requirements for their EU subsidiaries based on Swiss regulatory standards while remaining under the supervision of the Swiss FINMA.

Although the equivalence decision reduces compliance costs by avoiding duplicative regulation, it does not grant Swiss insurance companies the ability to sell insurance directly to the EU market without establishing an EU subsidiary. This is because the equivalence framework under the Solvency II Directive does not address market access issues. As discussed earlier in Chapter 4, the three areas of equivalence rules under the Solvency II Directive only focus on regulatory alignment rather than granting third country firms direct entry into the EU market.

Nevertheless, by granting equivalence to Switzerland's insurance regulatory and supervisory framework, the European Union recognises the Swiss FINMA as the supervisory authority for global insurance groups. Additionally, European Union-based groups can incorporate the results of the Swiss Solvency Test (hereinafter SST) when calculating their group solvency requirements. Equivalence recognition also has a positive impact on reinsurance companies, as it enables them to provide services directly from Switzerland to their EU clients without being placed at a competitive disadvantage compared to European Union-based reinsurance firms⁴²⁰.

5.3.1.2 Reinsurance Equivalence: Divergent Treatment of the United Kingdom and Switzerland

The European Union's generous equivalence recognition granted to Switzerland in the reinsurance sector is partly linked to the Union's structural dependence on third country reinsurance providers. According to data published by EIOPA in 2024, as of 2021, reinsurance undertakings from non-EEA third countries accounted for 35.15% of total recoverables across the European market. Of this, 18.39% originated from 'equivalent' third countries, while 16.76% came from 'non-equivalent' third countries⁴²¹. Among the

⁴²⁰ Kern Alexander, 'The UK's Third-country Status Following Brexit: Post-Brexit Models, Third-Country Equivalence and Switzerland' in Kern Alexander et al, *Brexit and Financial Services: Law and Policy* (Hart Publishing, 2018). 115

⁴²¹ European Insurance and Occupational Pensions Authority, *Supervisory Statement on Supervision of Reinsurance Concluded with Third Country Insurance and Reinsurance Undertakings: Impact*

non-equivalent jurisdictions, the United Kingdom was the primary source. This reflects the United Kingdom's historic role as a global reinsurance hub and its legacy alignment with the Solvency II framework, inherited from its time as an EU Member State⁴²².

Among European Union-based reinsurance undertakings, including major players such as SCOR, Munich Re and Hannover Re, approximately 80% of ceded business was transferred to third country reinsurers. Of this, 57% was ceded to reinsurers in equivalent jurisdictions, while 23% went to those in non-equivalent jurisdictions. The primary destinations for this reinsurance activity include Switzerland, the United States, Bermuda and the United Kingdom.⁴²³

Overall, the European Union exhibits a significant level of reliance on third country reinsurance providers. Given that the EU insurance sector is primarily dominated by domestic insurers, outsourcing reinsurance to third country operators is generally viewed as beneficial to financial stability. This reflects a common feature of globalised financial markets – cross-border interconnectedness, which aims to ensure broader risk dispersion and thereby enhance the resilience of the financial system. This aligns with the central thesis of the present research: the European Union tends to open its equivalence framework preferentially to financial activities that are critical to market interconnectivity, provided that financial stability is not compromised. At the same time, to address the potential risks posed by such cross-border reinsurance activity, EIOPA has issued a supervisory statement advocating a risk-based approach to limit exposures to third country reinsurers and to ensure high-quality and consistent supervision⁴²⁴.

Switzerland possesses strong regulatory capacity and market strength, and its supervisory framework is widely regarded as being highly compatible with the European Union's Solvency II Directive. As a result, the European Union has had fewer concerns regarding financial security when granting equivalence to Switzerland. Although the United Kingdom also possesses a highly developed financial market, the post-Brexit regulatory decoupling and the potential for future regulatory divergence have introduced uncertainty

Assessment, EIOPA-BoS-24-074 (4 April 2024) 10.

⁴²² Ibid, 11.

⁴²³ Ibid, 12.

⁴²⁴ EIOPA, Supervisory Statement on the Supervision of Third-Country Reinsurance: Including Impact Assessment, Feedback Statement and Resolution of Comments EIOPA-BoS-24-074 to 077 (4 April 2024) <https://www.eiopa.europa.eu/document-library/supervisory-statement-supervision-reinsurance-concluded-third-country-reinsurance-undertakings_en>

regarding the long-term stability and alignment of the United Kingdom's supervisory framework with that of the European Union. This uncertainty, combined with the inherent competitive relationship between the two jurisdictions, has led the European Union to adopt a more cautious and non-reciprocal stance towards the United Kingdom.

Following the 2016 Brexit referendum, the European Union's focus shifted decisively towards managing its relationship with the United Kingdom; Europe's largest financial centre. The European Union was concerned that granting comprehensive equivalence to the United Kingdom could undermine the competitiveness of the European Union's internal financial market and trigger a relocation of financial activity and jobs back to London. In this context, activating a mechanism that could potentially grant the United Kingdom – and other major financial centres – market access became politically sensitive. The United Kingdom is not only a major player in the reinsurance sector, but also the European Union's strongest competitor in the broader field of financial services. The European Union's decision not to grant equivalence to the United Kingdom can thus be interpreted as a strategic instrument aimed at weakening the dominance of the City of London in the European financial landscape.

The European Union's decision to grant equivalence to Switzerland was based on Switzerland's proactive regulatory convergence. Following the adoption of the Solvency II Directive, FINMA actively adjusted its domestic rules to ensure a high degree of alignment with EU standards. This voluntary and sustained alignment led the European Union to conclude that Switzerland's regulatory framework offers a comparable level of investor protection and financial stability. It reflects a relationship grounded in mutual trust and regulatory co-operation, as well as recognition of Switzerland's status as a global reinsurance hub.

In sharp contrast, following Brexit, the United Kingdom's supervisory authority, the Prudential Regulation Authority (hereinafter PRA), began exploring the path of regulatory divergence, aiming to develop rules more tailored to the specific needs of the UK market (see sector 5.4 below). While the United Kingdom has maintained that its new framework would not weaken prudential standards, this intentional departure from EU norms fundamentally undermines the mutual trust that had previously been built on regulatory alignment. From the European Union's perspective, the unpredictability of the United

Kingdom's future regulatory direction makes it imperative to withhold equivalence as a means of preserving its own regulatory sovereignty and safeguarding the integrity of the EU financial system.

In short, the European Union's differentiated treatment of Switzerland and the United Kingdom reflects the core logic underpinning its approach to equivalence: equivalence is not merely an assessment of current regulatory frameworks, but also a judgement on future regulatory intentions and willingness to co-operate. Switzerland's 'follower' strategy has earned the European Union's trust, whereas the United Kingdom's 'decoupling' strategy has generated uncertainty and reinforced a sense of strategic competition. This divergence highlights that the European Union's equivalence determinations in the reinsurance sector are not purely technical supervisory decisions, but rather strategic choices shaped by a combination of sectoral characteristics, geopolitical rivalry and the imperative to safeguard regulatory sovereignty.

5.3.1.3 Dispute over Swiss Trading Venues under MiFIR Equivalence Framework

The same high-intensity logic is visible in the fact that equivalence may become connected to wider questions of institutional ordering. In Switzerland's case, recognition is not always confined to narrow sectoral comparability. Once the relationship is one of deep external integration, equivalence can become entangled with the broader terms on which Switzerland is permitted to maintain privileged access to EU-shaped economic space. This is what gives the Swiss variant its particular density: equivalence is not merely technical; it sits within a wider politics of legal and institutional proximity.

On 4 November 2015, the Swiss Federal Council approved a legislative proposal consisting of two Acts: (1) the Swiss Financial Services Act (hereinafter FinSA)⁴²⁵ and the Swiss Financial Institutions Act (hereinafter FinIA)⁴²⁶. These legislative proposals were introduced as part of post-2007–2009 global financial crisis reforms, aiming to bridge certain gaps between Swiss and EU financial services laws, particularly to align Swiss regulations with MiFID II. The Swiss rules are based on relevant EU financial legislation, including MiFID II and MiFIR, as well as the 2003 Prospectus Directive and the 2014

⁴²⁵ Bundesblatt 2015 9093, www.admin.ch/opc/de/federal-gazette/2015/8901.pdf.

⁴²⁶ Bundesblatt 2015 9139, www.admin.ch/opc/de/federal-gazette/2015/8901.pdf.

Packaged Retail and Insurance-based Investment Products Regulation (hereinafter PRIPs). However, they have been adjusted as necessary to accommodate the specific needs of the Swiss financial market and to fit within Switzerland's existing legal framework.⁴²⁷

The original version of the draft Financial Services Act, approved by the Federal Council, could largely be seen as closely aligned with the EU regulatory framework⁴²⁸. However, during subsequent parliamentary debates, certain amendments were introduced that further deviated the legislation from the MiFID II framework. This raised concerns about whether the European Union would ultimately grant an equivalence decision for Switzerland.⁴²⁹ The draft legislation was expected to be finalised in 2018 by the National Council (the large chamber of the Swiss Parliament).

Against this backdrop, the growing regulatory decoupling between Swiss and EU law, combined with the fundamental deadlock in negotiations over the Draft IFA, ultimately led the European Union to use the equivalence recognition of Swiss trading venues as a form of political leverage over Switzerland.

5.3.1.4 Draft Swiss/European Union Institutional Framework Agreement

The European Union has consistently criticised Switzerland's 'static' adoption model of EU law under which Swiss authorities selectively apply EU rules in practice, rather than automatically updating their legal framework in line with evolving EU legislation⁴³⁰. This approach fails to ensure dynamic regulatory alignment between the two parties. Since 2008, the European Union has called for institutional reform in Switzerland and has made it a precondition for negotiating any new market access agreements⁴³¹. At the heart of this

⁴²⁷ Federal Department of Finance FDF, 'FinSA and FinIA, Status as at July 2017' (Swiss Federal Department of Finance, July 2017) www.efd.admin.ch/efd/en/home/themen/wirtschaft--waehrung--finanzplatz/finanzmarktpolitik/fidleg-finig/fb-fidleg-finig.html.

⁴²⁸ R Sethe, 'Das Drittstaatenregime von MiFIR und MiFID II' (2014) 6 *Schweizerische Zeitschrift für Wirtschafts- und Finanzmarktrecht* 615, 624.

⁴²⁹ Kern Alexander, 'The UK's Third-country Status Following Brexit: Post-Brexit Models, Third-Country Equivalence and Switzerland' in Kern Alexander et al, *Brexit and Financial Services: Law and Policy* (Hart Publishing, 2018).

⁴³⁰ Centre for European Reform, 'Brexit Swiss-Style: The Best Possible UK-EU Trade Deal' (9 April 2017) <<https://www.cer.eu/publications/archive/policy-brief/2017/brexit-swissstyle-best-possible-uk-eu-trade-deal>>

⁴³¹ Elizabeth Howell, 'Post-'Brexit' Financial Governance: Which Dispute Settlement Framework Should Be Utilised?' (2020) 83(1) *Modern Law Review* 128

reform agenda lies the proposal to establish a comprehensive Institutional Framework Agreement (hereinafter Draft IFA) between Switzerland and the European Union⁴³².

The Draft IFA proposed the creation of a unified legal framework to replace the more than 120 existing bilateral agreements, thereby simplifying European Union–Switzerland relations and ensuring that Switzerland could more dynamically align its domestic legal updates with the evolving EU acquis. The agreement was modelled in part on the EEA framework, while still preserving Switzerland's legal and institutional independence. The Draft IFA also included a dispute settlement mechanism, similar to that of the United Kingdom–EU Withdrawal Agreement (hereinafter DWA), allowing disputes to be handled by an arbitration panel, with a specific clause stating that the Court of Justice of the European Union (hereinafter CJEU) would have the final authority on the interpretation of EU law where relevant.

However, the Draft IFA faced strong domestic opposition in Switzerland, ultimately leading the Swiss government to reject the agreement⁴³³. One of the most prominent and persistent objections centred on a constitutional concern over national sovereignty. Critics argued that the proposed institutional framework with the European Union would compromise Switzerland's autonomy, as it envisaged oversight by EU institutions and required, as a condition for continued market access, the recognition of a significant institutional role for the CJEU⁴³⁴. This also reflects the long-standing position of the CJEU that it is the sole and final authority on the interpretation of EU law and that no other body should be empowered to issue binding rulings on provisions of the EU acquis⁴³⁵. In disputes between the European Union and Switzerland involving EU law, the CJEU insists on maintaining this supreme interpretive authority⁴³⁶. However, this proposed role is

⁴³² European Commission and Swiss Federal Council, Draft Swiss–EU Institutional Framework Agreement (November 2018).

⁴³³ See Swiss Federal Department of Foreign Affairs, <<http://eda.admin.ch/dea/de/home/verhandlungen-offene-themen/verhandlungen/institutionellefragen.html>>

⁴³⁴ C Tobler, 'One of Many Challenges after “BrexIt”: The Institutional Framework of an Alternative Agreement; Lessons from Switzerland and Elsewhere?' (2016) 23 *Maastricht Journal of European and Comparative Law* 575, 578–579;

⁴³⁵ Court of Justice of the European Union (CJEU), Opinion 1/91 ECLI:EU:C:1991:490; Opinion 1/92 [1992] ECLI:EU:C:1992:189; S Blockmans and G Van der Loo, 'BrexIt: Towards an “EFTA-like” Dispute Settlement Mechanism' CEPS Commentary (August 2017) 2; Elizabeth Howell, “Post-“BrexIt” Financial Governance: Which Dispute Settlement Framework Should Be Utilised? (2019) 83 *Modern Law Review* 1

⁴³⁶ C Jagmetti, 'Ein Rahmenabkommen wuerde in die EU fuehren' *Neue Zürcher Zeitung* (5 October 2015) <www.nzz.ch/meinung/kommentare/ein-rahmenabkommen-wuerde-in-die-eu-fuehren-1.18625014>

difficult for an independent legal order such as Switzerland's to accept, as it represents a direct infringement on judicial sovereignty.

The breakdown of the Draft IFA negotiations was quickly transmitted into the domain of financial equivalence. At the end of 2017, the European Commission issued a time-limited equivalence decision on the Swiss stock exchange rules, reflecting a cautious and provisional approach. By December 2018, the equivalence decision for Swiss trading venues was extended for an additional six months⁴³⁷. However, on 30 June 2019, the decision expired, as the European Union chose not to renew it⁴³⁸.

Howell⁴³⁹ and Baur⁴⁴⁰ both argue that the European Union's decision to refuse the extension of Switzerland's trading venue equivalence status carried significant political implications. It is evident that the European Union linked the granting of Single Market access to the political progress of institutional negotiations with Switzerland. In essence, the European Union effectively revoked Switzerland's trading venue equivalence in a highly implicit manner. The European Union's refusal to renew the equivalence status of Swiss trading venues was clearly not the result of a mere legal or technical discrepancy. Rather, it was a direct consequence of Switzerland's rejection of the Draft IFA, which also entailed a rejection of deeper EU institutional oversight. This act of resistance represented a form of institutional dissent that the European Union found politically and strategically intolerable. This episode also served as a clear signal to other countries with similar relationships to the European Union (particularly the United Kingdom). The European Union sought to convey a firm message that access to the benefits of the Single Market also required acceptance of its rules and regulatory framework. Selective participation was not an option.

It is thus evident that the operation of the equivalence regime does not exist in isolation from broader political dynamics. Rather, it exhibits a heightened strategic regulatory function precisely in institutional grey zones and politically contested spaces. The

⁴³⁷ European Commission, Implementing Decision of 20 December 2018 on the Equivalence of the Legal and Supervisory Framework Applicable to Stock Exchanges in Switzerland (2018/2047).

⁴³⁸ See, for example, Mehreen Khan and Philip Stafford, 'EU-Based Traders Caught in Swiss "Equivalence" Spat' *Financial Times* (30 June 2019).

⁴³⁹ Elizabeth Howell, "Post-"Brexit" Financial Governance: Which Dispute Settlement Framework Should Be Utilised? (2019) 83 *Modern Law Review* 1

⁴⁴⁰ G Baur, 'The UK's Ability to Conclude Trade Agreements Post Brexit and Potential Frameworks' (CELS Brexit Symposium, Cambridge, March 2019).

European Union uses this mechanism as an interface, transforming what appears to be a technical assessment of financial regulation into a broader instrument for projecting political order. Switzerland, as one of the third countries most closely integrated with the European Union, was among the first to experience the extent of this regulatory–political mechanism fully in action. This is precisely the logic of the integrationist model. Equivalence is used not to contain a strategic rival, but to stabilise and institutionalise a relationship of regulatory closeness.

5.3.2 Peripheral jurisdictions as a low-intensity integrationist variant

Peripheral jurisdictions represent a lower-intensity form of the same integrationist logic. As with Switzerland, the European Union's basic orientation is not to contain these jurisdictions as regulatory rivals, nor to bargain with them as peers over the terms of mutual accommodation. The regime is again used to encourage alignment around EU-defined standards and to extend the practical reach of the EU regulatory order beyond its formal borders. In this sense, these jurisdictions belong within the same model. The difference is that the integrationist logic operates here in a looser and more permissive form.

This lower intensity reflects a different risk and power profile. Such jurisdictions are generally not proximate enough, large enough, or institutionally central enough to trigger the more defensive concerns associated with neighbouring competitors. Nor do they usually possess the market power, supervisory reach or international standing necessary to bargain with the European Union on roughly peer-level terms. They are more likely to be access-sensitive, more exposed to external normative influence, and more inclined to adapt to regulatory benchmarks established elsewhere.

This affects the weighting of the underlying drivers. Concerns relating to regulatory rivalry are comparatively weak because these jurisdictions do not typically threaten the European Union as alternative centres of financial rule production. Likewise, the autonomy-defensive logic that becomes prominent in the UK context is far less intense here. The European Union does not generally confront the same fear that recognition will empower a nearby competitor capable of using divergence strategically against the internal market.

Financial stability concerns also tend to be more muted, at least from the perspective of the European Union. This is not because such jurisdictions are necessarily irrelevant to market stability in absolute terms, but because they are usually less deeply embedded in the core infrastructures on which the Union depends for the operation of its own financial system. Their recognition is therefore less likely to recreate the kind of uncomfortable structural dependence visible in sectors such as UK-based clearing. The European Union can thus afford to be more open in granting recognition because the systemic downside of doing so is lower.

In these contexts, equivalence can be granted on the basis of lower-granularity alignment. The Union still expects sufficient convergence, and recognition still encourages domestic adaptation to EU standards, but the degree of synchronisation required is less exacting. Equivalence remains an instrument of incorporation into an EU-shaped regulatory orbit, yet the incorporation is thinner, less institutionally dense, and less politically charged than in the Swiss case.

Broadly speaking, aside from the European Union, the United States and the United Kingdom, all other jurisdictions in the global financial regulatory landscape can be considered peripheral jurisdictions. To avoid an overly fragmented discussion, this section focuses on Asian jurisdictions as illustrative examples of such peripheral actors.

5.3.2.1 Peripheral Jurisdictions as Cautious Adapters

Against the backdrop of G20-led financial regulatory reform, emerging Asian markets face a dilemma in adopting international standards. On the one hand, financial regulators in many Asian countries hold relatively weak influence on the global stage and are regarded as peripheral jurisdictions. This is not only due to limitations in regulatory expertise that hinder the development of alternative frameworks, but also because of their deep economic dependence on major financial centres such as the United States and the European Union. To enhance market resilience and gain international recognition, alignment with global standards becomes necessary. On the other hand, maintaining domestic market vitality and competitiveness requires regulatory tools tailored to national circumstances. Given that financial markets in peripheral jurisdictions often lack the scale and depth of their Western counterparts, indiscriminately transplanting complex regulatory techniques from the

European Union or the United States may suppress market liquidity and cause unintended harm to the local financial ecosystem. Consequently, while they support the G20 agenda and seek to promote domestic market development, they need to manage their existing relationships with financial entities from the United States and the European Union carefully⁴⁴¹. Low-intensity integrationism therefore does not begin with deep harmonisation, but with a more cautious form of adaptation shaped by dependence on external templates and sensitivity to domestic market conditions.

In fulfilling the political commitments of G20 financial regulatory reform, peripheral jurisdictions exhibit two core characteristics when adapting their domestic legal frameworks. First, they display a high degree of caution. In areas where the European Union and the United States have not yet resolved disputes or reached regulatory alignment, these jurisdictions tend to remain inactive. Second, they act as 'rule followers'. In the process of transatlantic coordination on international standards, peripheral jurisdictions often call on the European Union and the United States to reach a timely consensus. Their strategy is to wait until the major economies have settled their differences and established a clear international standard and only then proceed with targeted amendments to their domestic legal frameworks.

A good example is the regulatory requirements for margin on non-centrally cleared derivatives, Asian regulatory authorities have expressed the view that the region cannot address this issue until the United States and the European Union finalise their levels of non-cleared margin and resolve differences in negotiations with the Basel Committee and IOSCO⁴⁴². As for electronic trading platforms, East Asian regulators have recognised the divergent expectations set by Dodd–Frank and EMIR, specifically in terms of reporting requirements and the practical discretion exercised by platform operators. Similarly, the technical differences not only raise questions about which model Asia should follow when designing its own framework, but also lead to calls for delaying the implementation of

⁴⁴¹ Yu-wai Vic Li, 'East Asian Responses to Derivatives Regulatory Reform' in Eric Helleiner, Stefano Pagliari and Irene Spagna (eds), *Governing the World's Biggest Market: The Politics of Derivatives Regulation After the 2008 Crisis* (Oxford University Press 2018) 115.

⁴⁴² Lucia Quaglia, *The Politics of Regime Complexity in International Derivatives Regulation* (Oxford University Press 2020) ch 8.

electronic trading platforms in Asian jurisdictions⁴⁴³.

At the same time, adaptation at the periphery is not a matter of simple copying. It involves selectively adapting and modifying international standards to fit the specific conditions and needs of their national capital markets. This can be seen particularly clearly in the area of derivatives trading reform. After the Pittsburgh commitment that standardised OTC derivatives should, where appropriate, be traded on exchanges or electronic trading platforms⁴⁴⁴, both the United States and the European Union developed mandatory trading regimes for derivatives⁴⁴⁵. Those reforms created a powerful external template. Yet Asian jurisdictions did not simply reproduce it⁴⁴⁶. Concerns quickly emerged that mandatory platform trading might favour exchanges and trading venues located in the United States and the European Union, thereby reinforcing the advantages of the major financial centres⁴⁴⁷. In Singapore, regulators explicitly warned that moving trading onto platforms before sufficient market depth had developed could seriously impair liquidity⁴⁴⁸. In China, the challenge was even more pronounced. Much of the OTC derivatives market remained centred in the interbank market and depended on bilateral negotiation, established relationships, and an existing OTC plus bilateral credit structure⁴⁴⁹. A forced transition to transparent platform trading would therefore require not merely a legal amendment, but a broader reorganisation of pricing practices, risk management, margining frameworks and default arrangements.

For that reason, China and Singapore both adopted cautious and incremental reform paths. They prioritised core risk-reduction measures such as central clearing and margin

⁴⁴³ Philip Stafford, 'Quick View: Europe's MTF Problem' *Financial Times* (20 March 2014); Viren Vaghela, 'Crunch Time Over SEFs as Asian Banks Weigh Up Costs of Participation' *Risk.Net* (12 December 2013)

⁴⁴⁴ Group of Twenty (G20) Communiqué (G20 Leaders Summit Pittsburgh, 24–25 September 2009).

⁴⁴⁵ For EU trading platform obligation, see earlier chapter 3. As for the US trading platform reform, see eg., S Pagliari, 'The Second Half: Interest Group Conflicts and Coalitions in the Implementation of the Dodd–Frank Act Derivatives Rules' in E Helleiner, S Pagliari and I Spagna (eds), *Governing the World's Biggest Market: The Politics of Derivatives Regulation after the 2008 Crisis* (Oxford University Press 2018).

⁴⁴⁶ Details see Lucia Quagli, *The Politics of Regime Complexity in International Derivatives Regulation* (Oxford Press 2020) chap 4, 54.

⁴⁴⁷ C H Chen, 'Extraterritoriality of the Regulations and Interconnections of the Derivatives Market: Legal Implications for East and Southeast Asia' (2017) 11 *Masaryk University Journal of Law and Technology* 2

⁴⁴⁸ L Chuan Teck, 'Making the trading of Derivatives Safer', Speech (Monetary Authority of Singapore, Singapore, 29 November 2012) <<https://www.mas.gov.sg/news/speeches/2012/making-the-trading-of-derivatives-safer>>

⁴⁴⁹ T Zhou, 'Overview on Derivatives Trade in China' (2016) 12 *European Scientific Journal* 25, 857–788.

requirements, began with more standardised and liquid products, and moved only gradually towards trading reforms⁴⁵⁰. China's approach is especially revealing: mandatory central clearing for onshore RMB interest rate swaps was introduced without making centralised execution the exclusive mode of trading, allowing bilateral execution to continue while clearing obligations were imposed at the post-trade stage⁴⁵¹.

Accordingly, peripheral jurisdictions should not be understood as passive recipients of externally generated rules. Their strategy is better described as cautious adaptation. They seek the benefits of alignment with dominant regulatory models because market access, resilience and international recognition matter to them, but they also attempt to preserve domestic market viability by filtering those models through local institutional and economic conditions. That is why convergence at the periphery often appears partial, delayed, and highly selective. The point is not to resist integration altogether, but to absorb it in a form that domestic markets can sustain. It is precisely this combination of convergence and restraint that characterises the low-intensity integrationist variant.

5.3.2.2 The European Union as a Lenient Recogniser

If peripheral jurisdictions approach convergence cautiously, the European Union occupies the other side of the same low-intensity dynamic as a lenient gatekeeper. The EU remains the actor that controls recognition and access through the equivalence mechanism, and therefore retains the formal power to determine the terms on which third-country frameworks may be accepted. Yet, in relation to peripheral jurisdictions, this gatekeeping role is exercised in a relatively accommodating form. Unlike the Swiss case, where the relationship is shaped by proximity, market integration and the demand for a far higher degree of regulatory alignment, the EU's approach towards more peripheral markets is

⁴⁵⁰ Monetary Authority of Singapore, 'Response to Consultation on Policy Reforms on Regulation of OTC Derivatives (Part 2)' (3 August 2012); Monetary Authority of Singapore, 'Consultation Paper on Draft Regulations for Mandatory Clearing of Derivatives Contracts' (1 July 2015); Monetary Authority of Singapore, 'Response to Feedback Received on Proposed Margin Requirements for Non-Centrally Cleared OTC Derivatives Contracts' (6 December 2016); Monetary Authority of Singapore, 'Liquidity and Policy Analyses for Platform Trading of OTC Derivatives'.

⁴⁵¹ People's Bank of China, 'Circular on Issues Concerning RMB Interest Rate Swap Business' (PBC Document No 18 [2008]); State Council / PBC, 'PBC Notice on Establishing a Centralized Clearing Mechanism for OTC Financial Derivative[s] and Launching Centralized Clearing of RMB Interest Rate Swap' (8 April 2014); China Foreign Exchange Trade System, 'Business and Services of China Foreign Exchange Trade System'.

generally marked by looser conditions and a greater willingness to extend recognition without insisting on deep institutional homology.

The central reason for this relative leniency lies in the EU's assessment of risk. In its equivalence decisions and implementing acts, the European Union has repeatedly treated a number of Asian and other third-country jurisdictions as 'significantly lower risks' market⁴⁵² because where the scale of the relevant market is limited and the spillover potential for the EU internal market remains modest, granting equivalence is not viewed as posing an unmanageable threat to EU financial stability. That low-risk classification creates the conditions under which a more permissive recognition policy can be used as a technique of external governance. Because these peripheral jurisdictions do not present the same degree of systemic threat as a major neighbouring financial centre, the EU can afford to grant recognition more generously. This in turn encourages technical convergence towards EU standards. The result is a form of regulatory projection achieved not through coercive harmonisation, but through the strategic use of market access and recognition.

As Gilardi notes in his research on policy diffusion, learning is a key non-coercive mechanism. States observe the performance of policies in other countries and adjust their own practices accordingly⁴⁵³. In the context of equivalence assessments and mutual recognition arrangements, this learning process can be bidirectional, but it is more often the case that weaker or peripheral jurisdictions, in pursuit of market access, actively learn from and adapt to the regulatory practices of the dominant party⁴⁵⁴. Thus, the European Union strategically uses equivalence as a tool to project its regulatory model internationally, thereby enhancing its influence in global rule-making. The underlying logic is straightforward that the more jurisdictions align with EU rules, the more firmly the European Union consolidates its position in the international regulatory landscape.

⁴⁵² See Commission Implementing Decision 2014/754/EU of 30 October 2014 on the equivalence of the regulatory framework of Hong Kong for central counterparties to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories [2014] OJ L 311/62; Similar language appears in Commission Implementing Decision 2014/753/EU [2014] OJ L 311/58; Commission Implementing Decision (EU) 2016/2275 [2016] OJ L 342/57; Commission Implementing Decision (EU) 2016/2276 [2016] OJ L 342/61.

⁴⁵³ Fabrizio Gilardi, 'Transnational Diffusion: Norms, Ideas, and Policies' (2010) *Annual Review of Political Science* 13

⁴⁵⁴ For example, in order to retain eligibility for clearing transactions with parties in the European Union, nearly all Asian CCPs have submitted applications for EU third country recognition, concerning that transactions related to the European Union may shift elsewhere. See Yu-wai Vic Li, 'East Asian Responses to Derivatives Regulatory Reform' in Eric Helleiner, Stefano Pagliari and Irene Spagna (eds), *Governing the World's Biggest Market: The Politics of Derivatives Regulation after the 2008 Crisis* (Oxford University Press 2018) 126.

This helps explain why the low-intensity variant still belongs within the integrationist model. The integration involved here is weaker and more selective than in the Swiss case, but it remains integration nonetheless. Peripheral jurisdictions are encouraged to adapt their domestic frameworks because alignment with EU requirements offers access, recognition and reputational value. At the same time, the EU benefits from this process because wider adoption of its regulatory approach extends the practical reach of its standards beyond its own territory. The interaction is therefore mutually structured. Peripheral jurisdictions are not merely passive recipients of a unilaterally imposed framework, but neither is the EU merely acknowledging foreign diversity from a position of neutrality. Rather, equivalence becomes a channel through which selective convergence is fostered under conditions of low risk.

At the same time, the EU's gatekeeping role is not unlimited in practice. Because low-intensity integrationism operates in jurisdictions where market access runs in both directions, peripheral feedback cannot simply be ignored. It shows that if EU policies undermine local market conditions, the competitiveness of EU firms operating in those jurisdictions may also be harmed. This creates a two-way risk. Formally, the equivalence regime grants the EU unilateral discretion. Practically, however, the EU must remain attentive to the effects of its policies on third-country markets and on EU firms active within them. As the text puts it, the EU cannot ignore policy feedback from peripheral jurisdictions and may need to adjust the operation of equivalence through ongoing consultation.

The Japanese margin dispute provides a particularly clear example. Under the EMIR framework, some exemptions relating to margin requirements for non-centrally cleared OTC derivatives were available only to European end-users, while Asian counterparties remained fully subject to the rules. This produced an asymmetry in margin obligations and triggered regulatory backlash, especially from Japanese authorities and banks, which signalled that they would explore alternatives if the EU position were not revised⁴⁵⁵. The conflict was eventually resolved through the formal recognition of the equivalence of Japan's legal, supervisory and enforcement framework for non-centrally cleared OTC derivatives. More broadly, the material suggests that pressure from Asian regulators, together with the commercial interests of European trading firms, encouraged a shift

⁴⁵⁵ Viren Vaghela, 'Japan Slams European Rules on Bilateral Swaps' (14–15 September 2014) Asia Risk.

towards a more outcomes-based understanding of equivalence. This does not displace the EU's role as gatekeeper, but it does show that even a lenient gatekeeper must adapt where the costs of rigid unilateralism become too high.

Taken together, these features explain why peripheral jurisdictions represent the low-intensity variant of the integrationist model. On one side, those jurisdictions adapt cautiously, selectively and incrementally to dominant external templates. On the other, the European Union responds through a form of gatekeeping that is lenient precisely because the risks are low and the costs of accommodation are manageable. The result is not deep alignment of the Swiss kind, but neither is it mere coexistence. It is a looser form of integration, sustained by limited risk, selective convergence, and the mutual strategic value of recognition.

More broadly, the integrationist model demonstrates that equivalence is not merely a binary instrument of market access. It is a mechanism through which the European Union can organise varying degrees of external convergence around its own regulatory framework. Sometimes this convergence is thick, granular and politically embedded; sometimes it is thinner, broader and more permissive. But in both forms, equivalence functions as an instrument of conditional incorporation rather than as a tool of exclusion or peer bargaining. This is what distinguishes the integrationist model from the defensive and negotiationist models examined in the following sections.

5.4 The Defensive Model: the United Kingdom

The United Kingdom illustrates the defensive model. Following Brexit, the United Kingdom ceased to be an internal participant in the European Union financial order and became a third country with an unusually complex profile. In the absence of a bilateral agreement on market access for financial services, UK policymakers would need to assess the usefulness of seeking equivalence determinations under the 'equivalence provisions' of various pieces of EU financial services legislation.⁴⁵⁶ The United Kingdom remained deeply connected to the European Union's financial system, especially in infrastructure and wholesale markets, yet it also constituted the European Union's most significant

⁴⁵⁶ Kern Alexander, 'The UK's Third-country Status Following Brexit: Post-Brexit Models, Third-Country Equivalence and Switzerland' in Kern Alexander et al, *Brexit and Financial Services: Law and Policy* (Hart Publishing, 2018).

neighbouring competitor in financial services. The United Kingdom was therefore not merely another third country seeking access. It was a structurally intertwined rival.

5.4.1 Post-Brexit Structural Rivalry

The United Kingdom occupies a structurally distinct position from Switzerland because it is not merely a neighbouring jurisdiction seeking access to the internal market from the outside. It is a former insider whose financial system was deeply embedded in the EU market at the point of exit, whose domestic framework initially preserved a high degree of formal similarity with EU law, and whose market infrastructure, institutional capacity and international standing allow it to function as a potential competing centre of financial regulation. This matters because the legal question facing the European Union is no longer simply whether a neighbouring third country can be trusted to converge. It is whether granting equivalence would allow a proximate and highly sophisticated external jurisdiction to retain substantial market influence while recovering the freedom to diverge.

That combination sharpens the autonomy-defensive dimension of equivalence. In the UK setting, the European Union must manage not only the risks arising from cross-border dependence, but also the possibility that the United Kingdom may use regulatory differentiation to preserve or enhance the international competitiveness of the City of London⁴⁵⁷. Equivalence is therefore recalibrated. It cannot operate in the same integrationist fashion as in the Swiss case. The regime instead assumes a defensive form: one that seeks to contain dependence, minimise the risk of regulatory leakage back into the internal market, and preserve the Union's own institutional primacy. Under the defensive model, core function of equivalence is instead one of boundary management. The European Union uses equivalence to regulate the terms on which a proximate external competitor may continue to participate in the market space shaped by EU law, while seeking to prevent that participation from undermining the autonomy, coherence or long-term strategic direction of the internal market.

⁴⁵⁷ Although the United Kingdom initially retained much of the EU-derived legal framework through the European Union (Withdrawal) Act 2018, subsequent reforms, including the Retained EU Law (Revocation and Reform) Act 2023 and targeted changes in financial regulation, have opened the way for gradual divergence from EU standards in ways intended to enhance the competitiveness of the UK market. See European Union (Withdrawal) Act 2018, c 16; Retained EU Law (Revocation and Reform) Act 2023, c 28; Bank of England, 'CP4/23 – The Strong and Simple Framework: Liquidity and Disclosure Requirements for Simpler-regime Firms' Consultation Paper (2023); Financial Conduct Authority, 'FCA Overhauls Listing Rules to Boost Growth and Innovation on UK Stock Markets' (Press Release, 11 July 2024).

This also explains why financial stability does not displace the autonomy-defensive driver, even where EU dependence on UK-based services remains considerable. On the contrary, high dependence in strategically important sectors intensifies the political need to develop mechanisms of control, supervision and eventual disentanglement. In the UK case, financial stability and regulatory autonomy do not point in opposite directions. They are mutually reinforcing. The more the Union depends on UK infrastructures, the stronger the incentive to ensure that such dependence does not harden into a lasting form of external vulnerability.

Thus, access becomes selective and strategically contingent. Equivalence is not granted simply because rules remain broadly similar. Recognition may be withheld, delayed or narrowed where the European Union considers that the legal and market consequences of recognition would exceed its strategic benefits. In this sense, the defensive model departs from any expectation that formal similarity should naturally produce market access. Similarity may be a necessary condition for recognition, but it is no longer remotely sufficient.

Second, where recognition is granted, it is often structured through temporariness, instability or conditionality. The point is not to draw the third country into a framework of stable and trust-based integration, but to preserve room for recalibration. Temporary decisions, ongoing review, and the maintenance of legal uncertainty are not incidental features in this model. They are part of the governance logic through which the Union prevents external access from becoming institutionally entrenched on terms it can no longer control.

Moreover, the defensive model is accompanied by supervisory hardening. Where financial stability makes outright exclusion impracticable, the European Union seeks to compensate by increasing oversight intensity, strengthening third-country supervision, and encouraging the relocation or substitution of strategically important functions over time. Equivalence in this model therefore does not signal relaxed dependence. It signals managed dependence under pressure.

This dual position explains why the European Union's approach to the United Kingdom cannot be understood either as ordinary refusal or as ordinary accommodation. The

defining feature of the British case is selective tolerance under conditions of rivalry. In sectors where dependence on the United Kingdom is limited, the European Union has been willing to refuse equivalence and internalise activity within the Union. In sectors where dependence is substantial and abrupt exclusion would threaten financial stability, the European Union has granted recognition, but in a provisional, constrained and strategically reluctant form. Defensive equivalence therefore does not produce uniform closure. It produces differentiated management of exposure.

5.4.2 Low-Dependence Sector: Refusal in Equity Trading

The European Union has shown little enthusiasm for granting equivalence to the United Kingdom. To date, under the EMIR, United Kingdom-regulated markets have not been recognised as eligible venues for distinguishing between over-the-counter (hereinafter OTC) and on-venue transactions. Similarly, under the MiFIR, trading venues for transactions subject to the Share Trading Obligation (hereinafter STO) and the Derivatives Trading Obligation (hereinafter DTO) have not received equivalence recognition from the European Union.⁴⁵⁸ This reluctance stems not only from the European Union's general distrust towards the United Kingdom, but also from the fact that, in the areas of equity and bond markets, the European Union is relatively less dependent on the services provided by the United Kingdom.

The 2024 edition of the European Commission's European Financial Stability and Integration Review (hereinafter EFSIR 2024) assessed the European Union's reliance on third country trading venues by examining the primary listing locations of EU issuers. Using market capitalisation share as the key metric, the report found that, across many industry sectors, EU stock exchanges served as the primary listing venue for more than 99% of EU companies.⁴⁵⁹ In fact, the vast majority of initial public offerings (hereinafter IPOs) completed by EU issuers between 2021 and 2023 took place on EU markets. Approximately 95% of EU issuers – accounting for 90% of total IPO proceeds – chose EU trading venues as their primary listing location. By contrast, nearly 3% of EU companies

⁴⁵⁸ European Commission, List of Equivalence Decisions Taken by the European Commission, (2023) <https://finance.ec.europa.eu/system/files/2023-11/overview-table-equivalence-decisions_en.pdf>

⁴⁵⁹ European Commission, European Financial Stability and Integration Review 2024 (European Commission, 2024) <https://finance.ec.europa.eu/publications/european-financial-stability-and-integration-review-efsir_en>

conducted their IPOs on US markets, representing 6.4% of the total funds raised.⁴⁶⁰ As for the bond market, according to data from the International Capital Market Association in 2022⁴⁶¹, 59% of EU sovereign bonds were traded within the European Union. However, the UK market – accounting for 41% of trading volume – continued to provide liquidity for bonds denominated in euros and issued by EU sovereigns.⁴⁶²

The data analysis reveals that, in terms of trading venues, the European Union holds a certain strategic advantage over the United Kingdom. Given the European Union's relatively low dependence on the United Kingdom's jurisdiction in both equity and bond markets, this has provided a foundation for its default refusal to grant permanent equivalence to UK trading venues. In this area, the defensive model takes its strongest form. Because structural dependence on the United Kingdom was limited, the European Union could pursue exclusion without incurring unacceptable systemic costs. Refusal of equivalence in equity trading therefore served not only as a legal decision, but as a strategic assertion of internal market autonomy. The European Union could allow business to relocate, encourage internal market deepening, and avoid reinforcing the market position of a powerful external competitor. This sector shows that defensive equivalence includes the possibility of non-recognition where the European Union has the capacity to bear the consequences. In that sense, refusal itself becomes part of the governance strategy.

5.4.3 High-Dependence Sector: Conditional Recognition in CCP Clearing

The position is different in central clearing. Here, the post-Brexit reality was marked by a very high degree of continued EU dependence on UK-based CCPs. The legal and market significance of this fact is central to the model. It meant that outright exclusion was not a credible short-term option, since the sudden loss of access could have generated serious disruption for EU market participants and raised immediate financial stability concerns.

⁴⁶⁰ European Commission, European Financial Stability and Integration Review 2024 (European Commission, 2024) <https://finance.ec.europa.eu/publications/european-financial-stability-and-integration-review-efsir_en>

⁴⁶¹ International Capital Market Association, European Secondary Bond Market Data H2 2022 (2023). It examines the share of trading volume (measured by notional value) for sovereign bonds issued by EU Member States and euro-denominated corporate bonds (thus including euro bonds issued by non-EU companies). The underlying data are estimated to cover approximately 80% of total bond trading volume and include only transactions conducted within the EU and the United Kingdom.

⁴⁶² European Commission, European Financial Stability and Integration Review 2024 (European Commission, 2024) <https://finance.ec.europa.eu/publications/european-financial-stability-and-integration-review-efsir_en>

Yet this did not lead the Union to revert to an integrationist logic. The response was instead to permit continued access on a constrained and unstable basis while simultaneously redesigning the supervisory and strategic framework around that access.

In assessing the consequences of Brexit, EU policymakers and authorities have expressed concern over the financial stability risks associated with EU market participants' heavy reliance on UK clearing services for key derivatives markets. As of December 2020, nearly 80% of OTC derivatives positions held by euro area clearing participants, as well as the majority of exchange-traded derivatives (hereinafter ETD) positions, were still being cleared through UK CCPs.⁴⁶³ The reliance was particularly pronounced in the case of OTC interest rate derivatives (hereinafter IRD) in euro and Polish zloty cleared at LCH Ltd, as well as credit default swaps (hereinafter CDS) and short-term interest rate derivatives (hereinafter STIR) in euro cleared at ICE Clear Europe. Both CCPs are considered to be of substantial systemic importance for the European Union⁴⁶⁴.

Despite a moderate increase in market share for euro-denominated clearing services across all three segments by euro area-based CCPs in the first three years following Brexit, the overreliance of euro area market participants on non-euro area clearing services remains a persistent concern.⁴⁶⁵ On average, based on notional amounts, 74% of counterparties involved in cleared transactions, including 76% for interest rate derivatives, are non-EU entities, with the majority located in the United Kingdom. This exposure to United Kingdom-based counterparties indicates that the EU derivatives market is also heavily reliant on the United Kingdom for central clearing services.⁴⁶⁶

Data from the Clarus database confirms this pattern of reliance. As of the end of 2023, among the €91 trillion in euro-denominated contracts recorded, only 18.3% were cleared by European Union-based CCPs, while 75.8% were cleared by UK CCPs and 5.9% by US CCPs. Contracts denominated in US dollars also showed significant dependence on UK CCPs, which accounted for approximately half of the outstanding notional amount. Overall,

⁴⁶³ Oana Furtuna, Susanne Kretschmann and Francesco Vacirca, Financial Integration and Structure in the Euro Area 2024, (European Central Bank 2024) <https://www.ecb.europa.eu/press/fie/box/html/ecb.fiebox202406_02.en.html>

⁴⁶⁴ Ibid.

⁴⁶⁵ Ibid.

⁴⁶⁶ European Commission, European Financial Stability and Integration Review 2024 (European Commission, 2024) <https://finance.ec.europa.eu/publications/european-financial-stability-and-integration-review-efsir_en>

the European Union's total reliance on non-EU CCPs approached 80%, representing a substantially higher order of magnitude⁴⁶⁷.

The European Union's continued heavy reliance on UK clearing services may pose significant risks to its financial stability, particularly under stressed market conditions. Central counterparties typically follow the instructions of their domestic regulators in times of crisis, making risk management decisions aimed at rapidly reducing exposures and containing potential losses. Such decisions may include raising margin requirements, adjusting eligibility criteria for collateral or modifying collateral haircut rates. These measures could trigger a chain reaction in the market, exacerbating financial pressure on EU counterparties and potentially destabilising the broader EU financial system.

From a monetary policy perspective, disruptions in key derivatives markets may also impair the effective transmission of policy instruments. Euro-denominated STIR play a central role in the operation and monitoring of monetary policy. Central banks rely heavily on these markets to assess market responses to policy measures and to gauge the effectiveness of transmission channels. Moreover, they serve as a vital conduit for communicating policy stance and forward guidance to the market. Accordingly, any disruption in these markets could significantly undermine the transparency and effectiveness of policy implementation.⁴⁶⁸

Given the United Kingdom's demonstrated tendency to diverge from EU regulation through legislation reforms, there is a risk that, in times of market stress, UK authorities may prioritise domestic concerns over the financial stability of the European Union. From the European Union's perspective, this introduces a degree of uncertainty regarding the preferred outcomes of crisis management measures.

To safeguard financial stability in the euro area, the European Central Bank (hereinafter ECB) proposed a policy requiring all CCPs clearing significant volumes of euro-denominated derivatives to be located within the eurozone, thereby enhancing its supervisory control. Although the ECB's location policy was annulled in United Kingdom

⁴⁶⁷ Ibid.

⁴⁶⁸ Fabio Panetta, 'Central Clearing in Turbulent Times: Frontiers in Regulation and Oversight' Keynote speech (Fifth Joint Deutsche Bundesbank, European Central Bank and Federal Reserve Bank of Chicago Conference on CCP Risk Management, Frankfurt am Main, 22 June 2023) <<https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230622~e1a8c64758.en.html>

v ECB⁴⁶⁹ because it fell outside the ECB's then-existing competence, the judgment did not reject the underlying objective of closer EU control as such. Rather, it indicated that the difficulty lay in the legal basis chosen, not in the policy logic itself.

That preference for tighter EU supervisory control was institutionalised in EMIR 2.2. By strengthening the EU framework for the supervision of systemically important third-country CCPs, the reform made continued access increasingly conditional upon enhanced EU oversight. At the same time, the retention of stronger options, including the possibility of market-access restrictions or relocation, signalled that such reliance was not intended to remain permanent⁴⁷⁰. The European Union's position was thus clear that dependence on UK CCPs might still be accepted for the time being, but only under tighter regulatory control and in parallel with a strategy aimed at gradually diminishing that dependence.

Ironically, from the perspective of formal 'regulatory similarity' or 'legal continuity', the United Kingdom should have been one of the most straightforward jurisdictions to be granted equivalence. In practice, however, the European Union has extended equivalence decisions to jurisdictions with greater institutional divergence and more distant geographical ties, such as Japan, Singapore, Hong Kong and even Brazil. Therefore, the key variable is not whether the United Kingdom remains formally comparable to EU law in the abstract. It is the extent to which the European Union depends on the relevant UK-based service, infrastructure or market segment, and how far recognition in that sector would strengthen an external competitor whose future divergence remains politically salient. This is also where the defensive model is most fully visible. Recognition is granted, but only in a form consistent with restrictive tolerance. Continued reliance is accepted for the time being, yet it is paired with a much more intrusive framework of third-country supervision and with an explicit long-term objective of reducing dependence. In other words, equivalence does not mark the successful normalisation of an external relationship. It marks the beginning of a managed transition in which access is preserved for stability reasons while the Union develops institutional tools to constrain, monitor and eventually rebalance that dependence.

⁴⁶⁹ United Kingdom v ECB (T-496/11) [2015] ECLI:EU:T:2015:133.

⁴⁷⁰ Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs [2019] OJ L 322/1.

The United Kingdom also helps to clarify why the defensive model must be distinguished from the integrationist one. In the Swiss case, equivalence could function as a channel for managed convergence because Switzerland did not pose the same kind of competitive challenge to the European Union as an external financial centre seeking to preserve leadership through post-membership divergence. In the UK case, by contrast, the possibility of future divergence is not a secondary concern but a constitutive feature of the relationship. The problem is not how to integrate a proximate outsider into a wider EU-shaped order, but how to prevent a former insider from continuing to exercise comparable market influence without being constrained by the same institutional discipline. That is the essence of the defensive model. At the same time, the UK case demonstrates that equivalence can be used as a sovereignty-sensitive instrument even where formal comparability is unusually high.

5.5 The Negotiationist Model: The United States

The United States exemplifies the negotiationist model. As in the preceding sections, this does not mean that the United States is shaped by an entirely different set of policy drivers. The same underlying drivers remain present: the preservation of financial stability, the defence of EU regulatory autonomy, the management of competition and the external projection of the EU regulatory order. What changes is their relative weighting and, more importantly, the conditions under which they can be pursued. In the transatlantic setting, neither financial stability nor regulatory power projection can be effectively secured through the modes of conditional incorporation or strategic exclusion that were central to the Swiss and UK contexts. The United States is therefore the clearest example of a jurisdiction in which the underlying objectives of equivalence must be advanced through negotiation rather than through hierarchical conditioning.

This driver configuration reflects the United States' position as a regulatory peer. Unlike Switzerland, it is not a neighbouring jurisdiction primarily seeking access to the EU market on terms defined by the Union. Unlike the post-Brexit United Kingdom, it is not a former insider whose continued proximity can be managed through selective withholding of access to the internal market. The United States is a jurisdiction with its own global financial infrastructure, extensive market depth, significant extraterritorial reach, and long-standing capacity to influence the content of international financial regulation. That makes

it resistant to any model of equivalence built on the assumption of asymmetry. The European Union cannot realistically expect the United States to orient its domestic framework toward sustained convergence with EU law, nor can it easily discipline US regulatory choices by threatening to withhold access in the way it can in more access-dependent relationships.

Regulatory autonomy cannot here be defended through unilateral market-boundary management alone, but should instead be pursued through bargaining, particularly given that post-crisis financial regulation generated overlapping jurisdictional claims and the risk of duplicative or conflicting compliance obligations. Similarly, the EU's ambition to project its own regulatory preferences outward does not disappear; rather, it must be advanced through technical negotiation, reciprocal accommodation and attempts to shape the terms of comparability itself. Financial stability concerns operate in the same way. They remain important because transatlantic fragmentation in derivatives, clearing or other core market infrastructures can generate systemic costs, but they cannot be managed through straightforward exclusion without producing serious countervailing costs of their own.

Three sectors are discussed following, namely (1) derivatives markets, (2) CRAs and accounting standards, as focal areas of transatlantic regulatory coordination. These sectors are used as case studies to reveal the European Union's differentiated negotiation strategies with the United States. Under the negotiationist model, the principal function of equivalence is not to impose one-sided alignment, but to mediate an ongoing process of reciprocal adjustment between regulatory peers. Recognition is therefore not the endpoint of a unilateral EU assessment. Rather, the meaning of equivalence itself becomes part of a broader process of bargaining, in which questions of comparability, supervisory outcomes, substituted compliance, and mutual reliance are continuously negotiated in order to stabilise cross-border market activity under conditions of legal plurality. In this setting, neither side can simply impose its own framework hierarchically: both the European Union and the United States retain strong regulatory capacity, defend their own legal orders, and may nevertheless recalibrate positions, accept functional substitutes, or adjust supervisory expectations to avoid fragmentation and deadlock. The significance of equivalence in this model therefore lies less in inducing external convergence than in structuring interaction, preserving regulatory autonomy, and facilitating workable transnational compromise.

5.5.1 Equivalence in Derivatives Market

In the field of derivatives, transatlantic regulatory coordination has been particularly difficult and marked by strategic contestation. Although both the United States and the European Union supported centralised trading and clearing in the aftermath of the 2008 global financial crisis, a coordinated international framework for clearing has remained elusive. Instead, both jurisdictions have implemented domestic regulatory reforms with considerable extraterritorial reach.⁴⁷¹ Several factors have contributed to this outcome.

According to Posner's viewpoint, pre-existing developed transnational institutions are crucial in the formation of widely-accepted international regulatory rules, and this is precisely what is lacking in the international derivatives market.

Before the global financial crisis, the derivatives market relied primarily on self-regulation, with the ISDA leading the formulation of derivative rules. After the crisis, regulatory authorities lost trust in industry self-regulation. This resulted in a power vacuum at the international regulatory level for the formulation of derivative market rules. The Committee on Payment and Settlement Systems (hereinafter CPSS, later renamed as Committee on Payments and Market Infrastructures, hereinafter CPMI) and IOSCO lacked the same authoritative and institutionalised status as the Basel Committee in serving as a coordinating forum. Therefore, CPSS and IOSCO initially lacked the same level of authority and legitimacy as the Basel Committee during the early stages of international rule-making.

Moreover, the transnational standard-setting process of CPSS and IOSCO was overly slow and the standards developed were not sufficiently detailed to guide regulatory conflicts between the European Union and the United States. Faced with the urgent pressure brought about by the financial crisis, both the European Union and the United States adopted a regulatory strategy of implementing first and coordinating later. In comparison to the banking industry, the divergent process of forming detailed rules for CCPs and uncleared OTC derivatives margin preferences in the European Union and the United States exacerbated regulatory method differences and heightened conflicts. The sequence of

⁴⁷¹ Lucia Quagli, *The Politics of Regime Complexity in International Derivatives Regulation* (Oxford University Press 2020) chap 4.

'implementation first, regulation later,' especially, worsened the possibility of achieving a reconcilable compromise between the two parties.

In the aftermath of the global financial crisis, international regulatory coordination in the field of derivatives became increasingly fragmented, largely due to the absence of robust international rules and authoritative supervisory bodies. To safeguard their respective financial systems, the European Union and the United States – the two major financial jurisdictions – enacted extensive domestic legislation aimed at addressing regional systemic risks. These regulatory frameworks not only introduced comprehensive domestic oversight, but also incorporated a wide array of extraterritorial measures to address the inherently global nature of the derivatives market.

However, in the absence of a coordinated international rulebook and a robust cross-border coordination platform, differences in legislative techniques and regulatory priorities between the European Union and the United States have resulted in clashes and incompatibilities between their respective regimes. This uncoordinated approach to rule-making has further exacerbated the complexity of global derivatives regulation, and has led to instances of legal and regulatory conflict between the two jurisdictions.

Owing to the fact that the European Union and the United States are the largest and most developed financial jurisdictions in the world today, they possess significant advantages in terms of market size and depth, financial practices and legislative techniques. Therefore, compared with other regulatory domains, the two dominant jurisdictions more frequently utilise bilateral forums rather than multinational forums to manage high-profile disputes. In other regulatory areas, transatlantic bilateralism is primarily manifested with involvement of varied transnational standard-setting bodies, financial stability committees and other multilateral organisations. In contrast, in the efforts to coordinate the implementation of Group of Twenty (hereinafter G20) derivatives regulatory principles, the United States and the European Union have engaged in transatlantic bilateral negotiations outside multinational organisations. These negotiations have often been contentious, leading to slow progress and the derivatives market has become one of the most challenging areas to coordinate in international financial regulation.⁴⁷²

⁴⁷² Ibid.

In the absence of authoritative and technocratic international rule-making institutions for regulation, the negotiation process of the transatlantic bilateral forum formed by the European Union and the United States, as the world's two largest derivatives trading markets (accounting for nearly 95% of the global US\$ 630 trillion derivatives market in the initial stages of formulating and implementing derivatives regulatory rules⁴⁷³), essentially plays a role similar to that of international organisations in developing specialised derivatives regulatory rules and promoting international regulatory convergence. Alexander Schaub, the Director-General of the Commission's Directorate General to the Internal Market at the time, stated in a testimony before the Committee on Financial Services of the US House of Representatives in 2004 that 'regulatory equivalence' implies a need for regulatory authorities and market supervisors on both sides of the Atlantic to change their practices.⁴⁷⁴

From the perspective of EU legislators, equivalence can be understood as a means to protect the European Union's regulatory autonomy from the influence of extraterritorial jurisdiction rules imposed by the United States. According to Michel Barnier, who served as the Commissioner for Internal Market and Services and was also one of the principal architects of the EU post-crisis rulebook, the establishment of the equivalence regime is not about 'trying to establish extraterritoriality here, just as we do not accept extraterritorial measures that the Americans sometimes implement', but rather about promoting the possibility of 'common standards, interoperability of rules and equivalence when it comes to supervision in particular'. Barnier emphasises the fact that 'Europe needs to keep its autonomy and sovereignty in this area'. This shows that the European Union's establishment of the equivalence regime also serves as a means to defend against the extraterritorial reach of US regulation, allowing the European Union to maintain the competitiveness of its own regulatory standards in financial markets rather than passively accepting US rules.

In this sense, the equivalence framework can be used as a competitive instrument for projecting international regulatory templates; in other words, the European Union's equivalence regime and the United States' substituted compliance, both recognition

⁴⁷³ Committee on Capital Markets Regulation, Letter to the European Commission and CFTC, Re: European Commission and CFTC Should Recognize Derivatives Clearinghouses ("CCPs") (21 August 2014).

⁴⁷⁴ Alexander Schaub, Testimony of Alexander Schaub, Director-General, Directorate General Internal Market of the European Commission before the Committee on Financial Services (Committee on Financial Services, US House of Representatives, Washington DC (13 May 2004).

systems, effectively serve as channels for international regulatory coordination and convergence. From the European Union's perspective, the equivalence regime becomes a coordination tool. After achieving transatlantic convergence of derivatives regulatory rules through negotiations with the US derivatives regulatory authorities (Commodity Futures Trading Commission, hereinafter CFTC and the Securities and Exchange Commission, hereinafter SEC), the regulatory templates of the European Union and the United States, as leading actors, are uploaded as international rules. These rules are then downloaded and applied by other jurisdictions (such as East Asia) in a process that reflects the achievement of regulatory convergence on an international scale.

In the context of the complex and protracted transatlantic negotiations over the derivatives market, two key areas of regulatory friction have been selected as case studies of the European Union's negotiation strategy. The first concerns the dispute over the onshoring of OTC derivatives trading and the recognition of trading platforms; the second involves disagreements over regulatory requirements for CCPs in the context of mandatory central clearing.

5.5.1.1 Equivalence in Swaps Execution Facility

In the United States, the Dodd–Frank Act established a comprehensive regulatory framework for swaps-trading platforms. It introduced new types of facilities known as swap execution facilities (hereinafter SEFs) and imposed requirements that certain swaps subject to mandatory execution must be executed on a SEF or a designated contract market (hereinafter DCM). The requirements for SEFs under US law and the DTO under the European Union's MiFIR share a similar core rationale: both aim to mandate the trading of certain standardised and liquid OTC derivatives on regulated trading venues, in order to enhance market transparency and reduce systemic risk.

According to footnote 88 of the CFTC's May 2013 rules for SEFs, any trading platform where a 'US person' executes swaps, including platforms located overseas, must register with the CFTC and comply with US rules, even if the products traded are not mandated by the rules to be traded on these facilities.⁴⁷⁵ In other words, all US persons must trade made-

⁴⁷⁵ Commodity Futures Trading Commission (CFTC), Core Principles and Other Requirements for Swap Execution Facilities; Final Rule Federal Register 78 No. 107 (4 June 2013) 33475–33604. <<http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2013-12242>>

available-to-trade instruments on a registered SEF or a designated contract market. Owing to this rule, market participants covered by US rules are no longer allowed to trade on platforms that are not registered with the CFTC.

Through its definition of a 'US person,' the CFTC's regulatory rules apply to any swap execution platform involving a US person, even if the platform is located outside the United States. This means that as long as a US person trades on a foreign platform, that platform must register with the CFTC and comply with US regulations. The problem lies in the overly broad and complex definition of a 'US person.' It not only includes US citizens, residents and companies located in the United States, but may also extend to foreign entities controlled by US persons; foreign entities with their principal place of business in the United States, foreign branches of US banks and even certain foreign entities connected to the US through specific legal arrangements, such as conduit affiliates.⁴⁷⁶

The core objective of the 'US person' rule is to safeguard the integrity of US regulation by preventing domestic entities from circumventing domestic oversight through the use of offshore affiliates.⁴⁷⁷ This represents a jurisdictional approach based on the person, rather than merely the location of the transaction. In practice, this means that even if a transaction occurs entirely outside the United States, the mere involvement of a US Person grants US regulators jurisdiction over it. Such a definition introduces considerable legal uncertainty and imposes significant compliance burdens on foreign institutions. A fund or company initially presumed to have no links to the United States may unexpectedly find itself subject to US regulatory oversight due to its ownership structure or business relations and face substantial compliance costs as a result.

By comparison, the DTO under MiFIR also has extraterritorial effect: when an EU entity enters into a derivatives transaction covered by the DTO with a non-EU counterparty, the trade must take place on an EU trading venue or on a third country trading venue that has been recognised as 'equivalent' by the European Union (see chapter 3). But the MiFIR DTO focuses primarily on requiring EU entities to execute certain derivatives transactions

⁴⁷⁶ United States Commodity Futures Trading Commission CFTC, 'Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations' Federal Register 78 No. 144 (26 July 2013) 45292–45374.

⁴⁷⁷ J Trindle, 'U.S. May Give Way on Swaps Rules' Wall Street Journal (12 December 2012) <<https://www.wsj.com/articles/SB10001424127887324904004578535313407286392>>

on regulated trading venues. Its core objective is to ensure the stability and transparency of the EU financial market. Although non-EU entities may also be affected, the European Union's regulatory reach is primarily anchored in the conduct of EU entities themselves, rather than seeking to assert jurisdiction over all transactions globally that involve a 'US person' as the US regime does. In addition, although the MiFIR DTO may also give rise to conflicts, its equivalence regime provides a mechanism to resolve such tensions. If a third country's regulatory framework is deemed 'equivalent' by the European Union, these conflicts can be mitigated or avoided altogether. By contrast, the United States demonstrates less flexibility in this regard, often expecting other jurisdictions to directly adopt its rules rather than engaging in mutual recognition based on comparability.

This measure, owing to its strong extraterritorial nature, immediately faced opposition from derivatives market participants and foreign authorities. After negotiations with the European Commission, the US CFTC committed itself in July 2013 to providing transitional relief to different multilateral trading facilities (hereinafter MTFs) regulated by the European Union. The CFTC also negotiated with the European Commission to provide regulatory relief to foreign trading platforms subject to similar regulatory requirements as SEFs.⁴⁷⁸ Following on this commitment, the CFTC announced in 2014 that US financial firms could trade on "qualified MTFs" (that were 'appropriately overseen by home regulators') and remain subject to regulations that are comparable to and as comprehensive as US law.⁴⁷⁹

As noted in earlier chapters, the United States has also established a substituted compliance regime, which can, in principle, offer exemptions similar to the European Union's equivalence regime. However, in the context of SEFs, the CFTC has applied substituted compliance only in a very limited scope. Market participants have criticised the CFTC's approach to determining the comparability of foreign rules as both overly prescriptive and

⁴⁷⁸ United States Commodity Futures Trading Commission (CFTC) and European Commission, Cross-Border Regulation of Swaps/Derivatives Discussions between the Commodity Futures Trading Commission and the European Union—A Path Forward (Commodity Futures Trading Commission and European Commission 11 July 2013).

⁴⁷⁹ M Wetjen, Acting Chairman Mark Wetjen's Keynote Address (39th Annual International Futures Industry Conference: The Necessity for Global Harmonized Derivatives Regulation, Florida, 11 March 2014).

substantively inadequate, as it relies on a rule-by-rule comparison with the foreign jurisdiction, rather than adopting a broader, outcomes-based assessment⁴⁸⁰.

As critics have claimed, the implementation of this system did not unfold as easily as outlined in the declarations. European platforms complained that the conditions for them to continue providing access to US entities were overly stringent and the deadlines were too short, making it not worthwhile.⁴⁸¹ When the final deadline for European platforms to register with the CFTC as 'eligible MTFs' passed in 2014, none of the European platforms chose to do so.⁴⁸² As a result, there was a noticeable fragmentation of liquidity⁴⁸³.

European traders began opting to conduct euro interest rate swaps with other European counterparts, thereby avoiding being subject to US rules. According to a statistical report published by ISDA in 2014, 85% of euro IRS transactions took place between European entities, surpassing the 71% figure from September 2013, before the SEF rules came into effect.⁴⁸⁴

In response to this phenomenon, ISDA pointed out in its report that the US practices did not truly achieve the principles of substituted compliance, namely ensuring regulatory consistency, appropriate supervision, transparency and ongoing competition across jurisdictions. This is because regulatory authorities adopted the concept of promoting the concentration of derivatives trading in the strictest manner. In contrast, European regulatory authorities seemed prepared to offer some regulatory flexibility and would allow derivatives to be traded on multiple venues with various execution mechanisms.⁴⁸⁵ ISDA also noted that the SEF rules issued by the CFTC unnecessarily restricted acceptable methods for executing swaps. These requirements directly contradicted the goal of the

⁴⁸⁰ A Ackerman, 'SEC Poised to Give Overseas Firms Leeway on Swaps' Wall Street Journal (30 April 2013).

⁴⁸¹ J Parsons, 'European Venues Cool on CFTC Registration' Future & Options World (17 April 2014).

⁴⁸² Matthew Gravelle and Stefano Pagliari, 'Global Markets, National Toolkits: Extraterritorial Derivatives Rule-Making in Response to the Global Financial Crisis,' in Eric Helleiner, Stefano Pagliari and Irene Spagna (eds), *Governing the World's Biggest Market: The Politics of Derivatives Regulation after the 2008 Crisis* (Oxford University Press 2018).

⁴⁸³ International Swaps and Derivatives Association (ISDA), *Path Forward for Centralized Execution of Swaps*, April 2015.

⁴⁸⁴ *Ibid.*

⁴⁸⁵ *Ibid.*

Dodd–Frank Act of promoting SEF trading and the general principled approach of the US Congress to SEF regulation.⁴⁸⁶

Therefore, in practice, the US regulatory oversight of swap trading facilities exhibits a strong extraterritorial impact. Despite the CFTC declaring the feasibility of substituted compliance, the regulatory path deviated from the intended purpose of the substituted compliance regime. This regime did not truly achieve the goal of transatlantic regulatory coordination and mutual recognition based on a respectful model. In response, the European Union has not granted equivalence recognition to SEFs under the CFTC. According to a report released by the ISDA in April 2014, only 6% and 3% of Euro swaps and Sterling swaps subject to US trading authorisation were traded on US trading platforms.⁴⁸⁷ This fragmented state persisted until 2017 when the European Union and the United States finally reached an agreement and separately issued mutual exemptions for swap trading facilities within their respective jurisdictions.⁴⁸⁸

In December of 2017, the European Commission published Implementing Act and recognised that DCMs and SEFs established in the USA and authorised by the CFTC were subject to legally binding requirements which are equivalent to the EU regulatory requirements.⁴⁸⁹ Three days later, on 8 December 2017, the CFTC issued an Exempt Order pursuant to section 5h(g) of the Commodity Exchange Act, exempting all European Union-based MTFs and OTFs that were authorised under MiFIR, MiFID II or Market Abuse Regulation (hereinafter MAR) and maintained in good regulatory standing from the requirement to register as SEFs. The exemption took effect on 3 January 2018.⁴⁹⁰

⁴⁸⁶ Ibid.

⁴⁸⁷ International Swaps and Derivatives Association (ISDA), 'Made-Available-to-Trade (MAT): Evidence of Further Market Fragmentation; (4 April 2014).

⁴⁸⁸ United States Commodity Futures Trading Commission, 'CFTC Approves Exemption from SEF Registration Requirement for Multilateral Trading Facilities and Organised Trading Facilities Authorized Within the EU', Press Release No 7656-17 (8 December 2017); European Commission and US Commodity Futures Trading Commission, 'Joint Statement on Mutual Recognition of Derivatives Trading Venues' (Joint statement, Brussels/Washington DC, 5 December 2017).

⁴⁸⁹ COMMISSION IMPLEMENTING DECISION (EU) 2017/2238 of 5 December 2017 on the equivalence of the legal and supervisory framework applicable to designated contract markets and swap execution facilities in the United States of America in accordance with Regulation (EU) No 600/2014 of the European Parliament and of the Council, L 320/11

⁴⁹⁰ United States Commodity Futures Trading Commission (CFTC), Order of Exemption for Multilateral Trading Facilities and Organised Trading Facilities Authorized Within the European Union Under Section 5h(g) of the Commodity Exchange Act' (CFTC, 8 December 2017).

It should be noted that the exemptions granted by the CFTC for EU MTFs and OTFs are based on the overall regulatory framework of the European Union, although the form of granting exemptions is based on individual applications. This marks an institutional upgrade from one-platform-per-assessment to system-level recognition, which also substantially mitigates liquidity fragmentation. Furthermore, under the CFTC order, the European Commission is empowered to request such exemption for facilities that meet certain legal requirements be added to the list of MTFs and OTFs that were granted exempt SEF status under the order on an ongoing basis.⁴⁹¹

In 2018, the CFTC revised the 2017 Exemptive Order Appendix A to further include eligible EU MTFs/OTFs on the exemption list.⁴⁹² Subsequent revisions in 2022 expanded the scope to cover additional EU platforms, including those in the United Kingdom post-Brexit. These exemption mechanisms formally recognised European MTFs/OTFs as Exempt SEFs, allowing US institutions to execute swap transactions subject to the trading obligation on these platforms without requiring SEF registration.⁴⁹³

The overall framework exemption granted to EU MTFs and OTFs also affects MTFs and OTFs located in the United Kingdom. The Brexit agenda means that United Kingdom-based MTFs and OTFs are no longer part of the European Union's unified exempt framework. Consequently, they have been excluded from the list of eligible MTFs and OTFs covered by the EU order of exemption under section 5h(g) of the CEA. The CFTC will initiate a reassessment process for United Kingdom-based MTFs and OTFs to determine whether they meet alternative compliance requirements and are eligible for corresponding exempt status.⁴⁹⁴

⁴⁹¹ United States Commodity Futures Trading Commission (CFTC), CFTC Exempts Additional European Union Multilateral Trading Facilities and Organised Trading Facilities from SEF Registration Requirements, Release Number 8617-22, available at : <https://www.cftc.gov/PressRoom/PressReleases/8617-22>

⁴⁹² United States Commodity Futures Trading Commission, Amendment to Appendix A to Order of Exemption for Multilateral Trading Facilities and Organised Trading Facilities Authorized Within the European Union' (CFTC December 2018).

⁴⁹³ See United States Commodity Futures Trading Commission (CFTC), CFTC Exempts Additional European Union Multilateral Trading Facilities and Organised Trading Facilities from SEF Registration Requirements, Release No. 8617-22 (CFTC 26 October 2022) <https://www.cftc.gov/PressRoom/PressReleases/8617-22>

⁴⁹⁴ *ibid.*

5.5.1.2 Equivalence in Central Clearing Counterparties

Although both the European Union and the United States supported enhanced financial transparency and risk control in the aftermath of the 2008 financial crisis, primarily through the promotion of central clearing for OTC derivatives to prevent the spread of systemic risk, they failed to achieve effective coordination on common regulatory standards. Instead, each pursued distinct domestic reform paths with significant extraterritorial implications.⁴⁹⁵ The European Union centred its approach on EMIR, while the United States relied on the regulatory frameworks established under the Dodd–Frank Act, implemented through the CFTC and the SEC, which oversee their respective clearing markets.

In the United States, section 722 of the Dodd–Frank Act was interpreted by the CFTC as requiring CCPs wishing to clear swaps for US market participants to register in the United States as a DCO.⁴⁹⁶ This approach differs from the rules established for foreign clearing houses seeking clearance of derivative products listed on exchanges (referred to as futures products). In the case of futures, the US CFTC requires foreign central clearing parties to register and fully comply with its rules only when clearing futures products listed on US exchanges. The greater transparency, level of standardisation and liquidity of futures products means that they have not been not regarded as leading to the same types of opaque concentrations of risk, which requiring prudential measures, as swaps. In the case of futures, the CFTC required foreign CCPs to register and fully comply with its rules only when they sought to clear futures products that listed on a US exchange. The US rules simply required that foreign CCPs clearing for US persons were compliant with the relevant international standards if those CCPs sought to clear futures products that listed on a foreign exchange – products that therefore fell outside CFTC's market integrity and prudential mandate.⁴⁹⁷

⁴⁹⁵ Lucia Quagli, *The Politics of Regime Complexity In International Derivatives Regulation* (Oxford Press 2020) chap 4.

⁴⁹⁶ United States Commodity Futures Trading Commission (CFTC) Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act Federal Register 77, No. 134 (12 July 2012): 41213–41242.

⁴⁹⁷ Matthew Gravelle and Stefano Pagliari, 'Global Markets, National Toolkits: Extraterritorial Derivatives Rule-Making in Response to the Global Financial Crisis' in Eric Helleiner, Stefano Pagliari, and Irene Spagna (eds), *Governing the World's Biggest Market: The Politics of Derivatives Regulation after the 2008 Crisis* (Oxford University Press 2018).

In Europe, unlike the United States, EMIR does not differentiate between the types of cleared products (i.e., futures and swaps) and applies a single legislative regulatory framework to CCPs from third countries. Additionally, EU rules link new requirements to banking capital standards (Capital Requirement Directive IV), which imposed significantly higher capital requirements for exposures to third country CCPs not recognised under EMIR.⁴⁹⁸

The United States and the European Union have engaged in protracted negotiations in the field of central clearing. European authorities have clearly used equivalence to determine the comparability of foreign jurisdictions and have taken a stricter stance on the equivalence of major markets like the United States. This is due to these markets providing more opportunities for regulatory arbitrage and the resulting network effects leading to a high concentration of risk for EU businesses. This has led to prolonged and significant cross-Atlantic disputes between United States and EU regulators.

Between 2014 and 2015, the European Commission identified ten jurisdictions whose CCP regulatory frameworks were considered equivalent to EMIR.⁴⁹⁹ The rationale behind this decision was that, compared with US CCPs, the CCPs in these jurisdictions posed lower risks to the EU market, making a proportional approach appropriate. However, the recognition of equivalence did not extend to DCOs regulated by the United States. It was not until 2016 that equivalence was granted to DCOs regulated by the CFTC and later in 2021, to DCOs regulated by the SEC.

The motivating factors often revolve around market competition, as 'concerns about competitiveness have played a major role in the current spat between the United States and the EU'. Both jurisdictions are concerned that accepting each other's rules could have distributional consequences for London and New York as primary global hubs for derivatives trading.⁵⁰⁰

⁴⁹⁸ Ibid.

⁴⁹⁹ European Commission, Equivalence Decisions on Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories: Text with EEA relevance (updated compilation, accessed 25 August 2025) <https://finance.ec.europa.eu/document/download/ded285fd-3b12-40eb-8169-0a1c64c86af0_en?filename=emir-equivalence-decisions_en.pdf>

⁵⁰⁰ P Knaack, 'Innovation and Deadlock in Global Financial Governance: Transatlantic Coordination Failure in OTC Derivatives Regulation' (2015) 22 *Review of International Political Economy* 6, 1217–1248.

After lengthy and difficult negotiations, both parties made certain concessions. In the Implementing Decision Act released by the Commission, two key points of contention in the transatlantic negotiation were disclosed and highlighted. This provides important material for understanding the content of the transatlantic regulatory negotiations and offers insight into the concerns of the European Union in the field of central clearing. The first was the minimum liquidation period (or margin period of risk (hereinafter MPOR)) for financial instruments other than OTC derivatives, and the second was the difference between the 'cover 1' principle and 'cover 2' principle regarding default funds held by CCPs.

MPOR stands for the time period from the most recent exchange of collateral covering a netting set of financial instruments with a defaulting counterparty until the financial instruments are closed out and the resulting market risk is re-hedged. In the Implementing Act, to make a regulatory designation equivalent to US DCOs regulated by the CFTC, the European Commission noted the MPOR for financial instruments other than OTC derivatives for US CCPs was only one day, although applied for client accounts on a gross basis, whereas under EMIR the minimum liquidation period was two days, but margin may be provided on a net basis. Based on the technical advice of ESMA, the Commission finally admitted the difference between net and gross margin collection results in equivalent outcomes with respect to the amount of margin that DCOs hold with respect to the positions of clients, which compensates for the difference in the liquidation period. Consequently, the CFTC primary rules on margin requirements can be considered equivalent to EU law.

However, considering the current minimum two-day liquidation period regulations in the European Union, the initial margin paid by clients of EU CCPs will always be higher than the margin paid by them to US CCPs. This discrepancy could potentially lead to regulatory arbitrage across the Atlantic. In response to this, ESMA has issued its regulatory technical standards, stating that certain accounts meeting specific conditions can adopt a one-day minimum liquidation period, calculated on a gross basis, aligning with the United States.⁵⁰¹ This measure aims to reduce margin requirements for clients while maintaining the level of financial stability protection, thus enhancing the competitiveness of the EU derivatives market.

⁵⁰¹ European Securities and Markets Authority (ESMA), Final Report, Review of Article 26 of RTS No 153/2013 with Respect to MPOR for Client Accounts (4 April 2016) ESMA/2016/429.

ESMA proposed that the European Union amend its rules to align with those of the United States in order to enhance its own competitiveness. This suggests that such coordination was not based on a unilateral model in which the European Union sets the standards and expects the other party to comply. Rather, it reflects a more complex, bidirectional interaction. While the European Union sought to promote its own standards as international benchmarks during the negotiations, it also incorporated elements of US regulatory practice and made technical adjustments to its own framework. This form of institutional interaction stands in sharp contrast to the European Union's unilateral rule-export approach towards the United Kingdom and Switzerland.

As for the default recovery resources requirements in debate, CFTC initial primary rule with respect to liquidity risks did not require systemically important DCOs (hereinafter SI DCOs) and opt-in DCOs to maintain eligible liquidity resources to meet the cover 2 principle, that is, liquid resources to cover the default of at least the two clearing members to which it has the largest exposures.⁵⁰² However, after a lengthy negotiation process, the CFTC changed its rules and required SI DCOs and opt-in DCOs to apply the cover 2 principle where those DCOs have been designated as being systemically important in multiple jurisdictions or where they are involved in activities with a more complex risk profile. Given that all CCPs in the European Union are required to meet the cover 2 principle, the European Commission, therefore, granted equivalence recognition only to SI DCOs and opt-in DCOs that adhered to the cover 2 principle⁵⁰³ rather than all DCOs under CFTC supervision. The implementation of the two points mentioned above was similarly upheld in the equivalence recognition granted in 2021 for DCOs under SEC supervision⁵⁰⁴.

The external impact of the European Union's equivalence regime is bidirectional, manifesting not only in its influence on the regulatory rules of third countries but also in prompting appropriate enhancements to EU regulatory frameworks due to the regulatory rules of these third countries. The motivating factors often revolve around market competition. as both jurisdictions are concerned that accepting each other's rules could

⁵⁰² European Commission, Recital (11) Commission Implementing Decision (EU) 2016/377.

⁵⁰³ European Commission, Recital (15) Commission Implementing Decision (EU) 2016/377.

⁵⁰⁴ European Commission, Commission Implementing Decision (EU) 2016/377 of 15 March 2016 on the Equivalence of the Regulatory Framework of the United States of America for Central Counterparties that Are Authorised and Supervised by the Commodity Futures Trading Commission to the Requirements of Regulation (EU) No. 648/2012 of the European Parliament and of the Council, L 70/32.

have distributional consequences for London and New York as primary global hubs for derivatives trading⁵⁰⁵. Commercial considerations, particularly the need to protect the competitiveness of the European CCP against the backdrop of margin cost-based competition, have also influenced negotiations regarding the equivalence of foreign rules.

After reviewing the long negotiation process between the European Union and the United States on mutual recognition of central clearing, it becomes clear that the European Union adopted a markedly different negotiating posture compared with its approach towards Switzerland and the United Kingdom. This divergence is evident in two respects. First, the negotiations with the United States involved clarification of numerous technical details concerning the clearing process. Second, following the conclusion of the equivalence agreement with the United States, the European Union chose to amend its own clearing rules in line with US regulatory standards, driven by concerns over market competitiveness.

This suggests that in financial services sectors where equivalence with the United States is potentially achievable, the European Commission did not hold the same equivalence expectations as it did for Switzerland and the United Kingdom. Given the substantial regulatory power of the United States, it would be unrealistic to expect the United States to align itself unilaterally with European Union-prescribed standards. Instead, the equivalence regime served more effectively as a tool for regulatory influence, encouraging US regulatory frameworks in the clearing sector to converge towards EU standards, thereby extending the European Union's influence in shaping global regulatory norms.

At the same time, the European Union also incorporated certain US regulatory practices into its own framework through the course of these negotiations, thereby reshaping its domestic regulatory landscape. This process of mutual interaction is unique to the relationship between these two jurisdictions.

5.5.2 Equivalence in Credit Rating Agencies

The outbreak of the 2008 global financial crisis fundamentally changed the European Union's approach to CRAs. Prior to the crisis, the European Union primarily relied on

⁵⁰⁵ P Knaack, 'Innovation and Deadlock in Global Financial Governance: Transatlantic Coordination Failure in OTC Derivatives Regulation' (December 2015) 22 *Review of International Political Economy* 6 1217–1248 <<https://www.jstor.org/stable/24673112>>

international standards issued by IOSCO to regulate CRAs. This reliance was based on the assumption that globally harmonised regulatory standards would be sufficient to ensure market stability and transparency. However, the crisis exposed the fragility of this assumption, forcing the European Union to recognise that voluntary international codes were no longer adequate to address the problems revealed in the credit rating industry, such as conflicts of interest, high market concentration and regulatory reliance, as well as the failure and opacity of rating models⁵⁰⁶.

The European sovereign debt crisis further intensified the European Union's concerns over CRAs. During the crisis, rating agencies issued multiple downgrades of the sovereign credit ratings of several eurozone member states, including Greece, Ireland and Portugal. These downgrades triggered panic-driven sell-offs in the markets and led to a sharp rise in borrowing costs for the affected countries. At a time when large-scale borrowing was urgently needed to address fiscal deficits and bank bailouts, the elevated financing costs severely undermined these countries' ability to respond to the crisis⁵⁰⁷. The downgrade actions themselves exacerbated negative market sentiment. European Union officials believed that the behaviour of CRAs not only failed to stabilise the markets, but, in fact, became a key factor in intensifying the crisis and amplifying market volatility. This contributed to a 'self-fulfilling prophecy' effect.

The credit rating market is characterised by a high degree of oligopoly, which further complicated Europe's predicament during the financial crisis. Globally, the market has long been dominated by three United States-based agencies: Moody's, Standard & Poor's (hereinafter S&P) and Fitch Ratings. During the European sovereign debt crisis, this oligopolistic structure revealed its underlying geopolitical risks. The European Union's financial stability and the financing capacity of its sovereign states were, to a large extent, in the hands of three non-EU private companies. The rating actions of these agencies were perceived as biased and as exacerbating market panic, while the European Union lacked effective countermeasures.

⁵⁰⁶ See European Commission, Proposal for a Regulation Of The European Parliament and of the Council on Credit Rating Agencies, COM (2008) 704 final.

⁵⁰⁷ See, for example, g. Rabah Arezki, Bertrand Candelon and Amadou NR Sy, 'Sovereign Rating News and Financial Markets Spillovers: Evidence from the European Debt Crisis' IMF Working Paper WP/11/68, (International Monetary Fund 2011).

As a result, concerns over a perceived 'US ratings hegemony' became widespread across European political and academic circles at the time. This sentiment served as a major driving force behind the European Union's decision to establish an independent regulatory framework, aimed at reducing its reliance on external rating agencies. Through its own supervisory regime, the European Union sought to ensure that the conduct of CRAs would better align with European interests and the goal of financial stability.

As previously discussed in relation to CRAs (see Chapter 4), the credit rating market has long been dominated by US firms. Consequently, in the aftermath of the financial crisis, the United States did not significantly expand its extraterritorial control in this domain. In contrast, the European Union accelerated its financial legislative efforts in this area, with the core objective of enhancing market competition through regulatory means and gradually reducing its supervisory reliance on the three major US CRAs. This initiative aimed fundamentally to reshape the structure of the credit rating market, and ensure the autonomy and stability of the EU financial system⁵⁰⁸.

According to the Credit Rating Agencies Regulation (hereinafter CRAR), third country CRAs (hereinafter TC CRAs) that have not submitted an application to ESMA and been designated as a registered or certified TC CRA through the procedures specified in CRAR cannot have their credit ratings used within the European Union. The US government expressed concerns about the European Union's proposal and the European Union responded by assuring the United States that it would soon grant equivalence to the US regulatory framework.

The CRAR establishes a dual-track entry mechanism for TC CRAs. For TC CRAs deemed systemically important, access to the EU market is granted through the Endorsement Procedure, which requires the establishment of a subsidiary within the European Union, thereby ensuring the European Union's territorial control – in effect, a relocation requirement. Additionally, the home country's regulatory framework must meet standards that are 'as stringent as those set out in the CRAR. For TC CRAs that are not systemically important, access may be granted via the Certification/Equivalence Procedure, which does

⁵⁰⁸ European Parliament and of the Council Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on CRAs.

not require relocation to the European Union. However, this route still hinges on a prior equivalence assessment of the third country's regulatory framework.

Despite the adoption of the CRAR, which was aimed at promoting competition in the credit rating industry, and its subsequent amendments, the CRA market remains highly concentrated. According to data from the 2024 EFSIR, the three major global CRAs still account for 68.5% of the overall credit ratings market in the European Union and as much as 92% of the solicited credit ratings⁵⁰⁹. Non-EU CRAs not subject to European Union control could have a significant impact on the financial stability of the eurozone. Therefore, it is not surprising that the European Union seeks to strengthen its control over non-EU CRAs. Naturally, ESMA lacks jurisdiction to ensure that TC CRAs comply with EU regulatory requirements, but it can exercise 'extraterritorial' supervision by directly overseeing CRAs legally registered within the EU, including requesting information, conducting inspections and ultimately imposing sanctions.

The dual-track access mechanisms for TC CRAs outlined in the CRAR are both based on the recognition of the equivalence of third country regulatory frameworks. In practice, the European Commission's decision to recognise the US framework as equivalent has been particularly controversial. The core concept of the endorsement regime for CRA is that it should be 'as stringent as' the EU regime. However, in its first technical advice issued in 2009, CESR (the pre-crisis EU securities regulator, now replaced with ESMA) found that the US regulatory framework was clearly non-equivalent in three key areas, namely (1) quality, (2) methodology and (3) rating disclosure.⁵¹⁰ The CESR also noted that it considered further convergence between the United States and the European Union could only be achieved by 'future regulatory amendments to the Securities and Exchange Commission's rules'⁵¹¹.

The US system largely relies on the market's ability to assess the quality of credit ratings independently and determine the methods used for such ratings, with the power of

⁵⁰⁹ European Commission, European Financial Stability and Integration Review 2024 (Publications Office of the European Union 2024).

⁵¹⁰ Committee of European Securities Regulators (CESR), Technical Advice to European Commission on the Equivalence Between US Regulatory and Supervisory Framework and EU Regulatory Regime for Credit Rating Agencies (21 May 2010), CESR/10-332, 4.

⁵¹¹ Committee of European Securities Regulators. Technical Advice to the European Commission on the Equivalence Between the US Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies (21 May 2010).

oversight by the US SEC being limited. European regulatory authorities, in contrast, are particularly concerned with the disclosure of credit rating information, the quality of issued credit ratings and the nature of the methods used⁵¹². The negative advice from the technocratic authority led to bilateral discussions between the United States and the European Union. Finally, in July 2010 the US Congress passed the US Dodd–Frank Wall Street Reform and Consumer Protection Act, empowering the SEC with a greater ability to impose sanctions and even suspend agencies' operations. In the meantime, a new Office of Credit Ratings was also established to conduct an annual review of each agency and publish the results. Many of its provisions reflected European concerns and were a result of the negotiations between the European Union and the United States over the course of the year.⁵¹³ Following further discussions between the SEC and ESMA, the updated technical advice from ESMA suggests that the direct introduction of requirements in the Dodd–Frank legislation (through 'self-executing' provisions), along with statutory rules that the SEC could periodically issue, provides ample grounds for approving the equivalence of the legal and regulatory framework for US CRAs.

This resulted in a positive outcome for international regulatory coordination, with ESMA concluding in its 2012 technical assessment that the US regulatory framework had achieved equivalence.⁵¹⁴ Based on ESMA's technical advice, the European Commission ultimately recognised the US regime as equivalent in 2012 but committed itself to 'monitoring the evolution of US laws and regulatory frameworks'.⁵¹⁵

Following the crisis, the United States proactively adjusted its regulatory stance to bring its oversight of CRAs more in line with EU standards. During this process, an interesting 'side episode' had a significant impact on the negotiating positions of both parties. Previously, the United States had enacted the Sarbanes–Oxley Act⁵¹⁶, a piece of legislation with strong extraterritorial effects. It required all foreign companies listed in the United States, including European firms, to restructure their corporate governance frameworks to comply

⁵¹² *ibid.*

⁵¹³ Nikki Tait, 'SEC and EU in Talks to Resolve Ratings Impasse' *Financial Times* (25 April 2011).

⁵¹⁴ European Securities and Markets Authority (ESMA), *Technical Advice on CRA Regulatory Equivalence—US, Canada and Australia Final Report* (ESMA 18 April 2012).

⁵¹⁵ European Commission, *Commission Implementing Decision of 5 October 2012 on the Recognition of the Legal and Supervisory Framework of the United States of America as Equivalent to the Requirements of Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies*, [2012] OJ L 201/26.

⁵¹⁶ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

with the stringent requirements of the Act. This occasionally created conflicts with domestic corporate governance standards in Europe.

An important precedent was created for the European Commission. When the Commission later introduced a series of stringent corporate governance requirements for CRAs, targeting primarily United States-based firms, the SEC protested against what it saw as the European Union's unilateral exercise of regulatory authority. However, its position lacked conviction. Precisely because the United States had previously adopted a similar regulatory strategy through the Sarbanes–Oxley Act, it had forfeited the moral and legal high ground. This reversal of roles placed US regulators in a contradictory position, thereby weakening their opposition during the negotiations and facilitating the eventual regulatory convergence.⁵¹⁷

During the negotiations, the EU market served as a crucial bargaining chip. Under the CRAR, only credit ratings issued by agencies that are formally registered with the ESMA may be used for regulatory purposes, such as capital adequacy calculations under the Capital Requirements Regulation (hereinafter CRR) and Solvency II. These agencies are designated as qualified CRAs. In contrast, credit ratings from non-registered agencies are deemed non-eligible for regulatory use and any financial instruments rated by such entities are treated as unrated assets. According to CRR and Solvency II, unrated exposures attract higher capital charges, due to the inability of supervisory authorities to verify the underlying methodologies, governance and data transparency of the ratings. As a result, European banks, insurance companies and institutional investors are strongly incentivised to rely exclusively on ratings issued by ESMA-registered CRAs to avoid regulatory penalties.⁵¹⁸ In order to maintain the regulatory usability of their ratings within the European Union, major United States-based CRAs such as Moody's, S&P and Fitch Ratings have effectively been compelled to establish European Union-based subsidiaries and undergo formal ESMA registration. This phenomenon is commonly referred to as de facto mandatory registration and exemplifies the European Union's use of market access conditionality as a tool of regulatory externalisation.

⁵¹⁷ Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (2nd edn Cambridge University Press 2015).

⁵¹⁸ See European Commission, Art 4 of CRA Regulation (EC) No. 1060/2009; Art 113, Arts 135–138 of Capital Requirements Regulation (CRR) No. 575/2013.

Thus, this transatlantic negotiation on CRAs offers a classic example of how market size, legal precedent and strategic positioning jointly shape the landscape of international regulatory governance.

In conclusion, the 2008 global financial crisis marked a decisive turning point in the European Union's approach to regulating CRAs. Prior to the crisis, the European Union largely relied on voluntary international standards; a strategy that proved inadequate in addressing the highly concentrated market structure, entrenched conflicts of interest and the amplifying effects of rating actions on financial stability. In particular, the European Union's excessive reliance on the three major United States-based agencies – Moody's, S&P and Fitch Ratings – left it in a vulnerable and reactive position during the crisis.

To address this challenge, the European Union moved beyond passively accepting international standards and adopted a more strategic approach. On the one hand, the European Union remained dependent on the dominant position of the three major US CRAs, as their ratings functioned as the global language of finance, making it practically impossible for European investors and financial institutions to disengage fully from them. On the other hand, the European Union actively and assertively pressured the United States to revise its regulatory framework in accordance with EU standards.

Given the monopolistic position of US CRAs, the core of this strategic adjustment lay in managing the transatlantic relationship. Through the adoption of the CRAR, the European Union leveraged the size of its market as a bargaining tool and established strict thresholds for equivalence recognition. This 'trading market access for rules' strategy effectively compelled US CRAs and their regulatory framework to align more closely with EU standards, particularly in areas such as rating quality, methodological transparency and disclosure requirements. As such, the European Union's post-crisis regulatory approach to CRAs not only reflected its pursuit of financial sovereignty and market autonomy, but also represented a successful case of rule export through legislative instruments, contributing to a reshaping of the international financial governance order.

5.5.3 Findings from the United States Case

Compared with its approach towards neighbouring jurisdictions such as Switzerland, the European Union has adopted a markedly different strategic focus and institutional posture in its equivalence negotiations with the United States. A greater degree of realist flexibility has been emerging in its arrangements with the United States.

First, the fundamental reason why the European Union has not insisted on IFA-style institutional integration with the United States lies in the asymmetry of institutional bargaining power. Unlike jurisdictions such as Switzerland or the United Kingdom, the United States is not only one of the world's largest financial markets, but also a long-standing co-author of international financial regulatory standards. Whether within IOSCO, the FSB, the Basel Committee or in the post-G20 crisis governance process, the United States has consistently held a structurally dominant voice.

This structural positioning means that any unilateral attempt by the European Union to impose its regulatory regime, including its legal framework and judicial primacy, on the United States would not only lack political feasibility, but could also risk a breakdown in negotiations. Worse still, such a move could backfire by undermining the perceived legitimacy of the European Union's own institutional model in the international regulatory landscape.

Second, the European Union's strategic choice is also shaped by the practical complexity of transatlantic regulatory interaction. The European Union and the United States have long-standing divergences in areas such as derivatives clearing, margin requirements and default fund coverage standards. These differences are often deeply rooted in their respective legislative traditions, risk philosophies and market structures, making them difficult to reconcile through political negotiation alone.

Against this backdrop, the European Union has pursued a dual approach: on the one hand, seeking to promote its own standards as international benchmarks and, on the other, accepting a degree of regulatory complementarity and engaging in technical coordination. Compared to the IFA model, which emphasises full institutional integration, a layered

mechanism based on technical dialogue and gradual convergence of standards offers greater flexibility and control in managing transatlantic regulatory relations.

Upon recognising that it could not rely on regulatory precedent or institutional pressure to compel the United States to align with EU standards, the European Union recalibrated the functional expectations of its equivalence regime. This shift demonstrates that when dealing with powerful rule-making jurisdictions, the equivalence mechanism serves less as a tool of control and more as an instrument of influence projection, aimed at enhancing the international acceptance of EU rules.

5.6 Comparative Discussion: Equivalence as Structured Differentiation

The comparative analysis undertaken in this chapter demonstrates that the European Union equivalence regime is a legal instrument applied with varying degrees of political contamination. That formulation understates the extent to which differentiation is built into the practical operation of the regime. The more accurate view is that equivalence has become a structured form of external governance whose operation varies systematically according to the relationship between financial stability and regulatory power.

The Swiss case illustrates that where convergence is high and rivalry limited, equivalence tends towards incorporation. The British case shows that where rivalry is acute and dependence uneven across sectors, equivalence becomes a selective strategy of containment and exposure management. The American case demonstrates that where the third country is itself a regulatory power of substantial weight, equivalence is shaped through negotiation and reciprocal institutional adjustment. Peripheral jurisdictions, meanwhile, show how the regime also serves as a mechanism of broader rule diffusion.

What unites these apparently different outcomes is that none of them can be explained satisfactorily by reference to a neutral, uniform benchmark of technical comparability alone. Technical criteria remain relevant, but they do not determine practice in isolation. The European Union calibrates equivalence according to the strategic context in which regulatory reliance on a third country is embedded. Equivalence therefore functions less as a simple recognition device than as an instrument for organising differentiated forms of external financial integration.

This conclusion also helps clarify the relationship between policy drivers and functional models. Financial stability and regulatory power projection do not disappear from the analysis once the three models are identified. On the contrary, they become more analytically useful. They explain why the models emerge, why the same legal mechanism produces different external effects, and why sectoral variation is often central to the operation of the regime. The models are therefore not a departure from the underlying political logic of equivalence. They are the structured practical forms through which that logic is expressed.

5.7 Conclusion

This chapter has argued that the European Union equivalence regime operates in practice through three functional models: integrationist, defensive and negotiationist. This typology captures a central feature of the regime that is obscured when equivalence is treated merely as a technical benchmarking exercise. The European Union does not simply determine whether third-country rules are equivalent in the abstract. It decides how equivalence should function within a wider strategy of financial stability management, regulatory power projection (including maintaining regulatory autonomy, managing competition and external influence).

The integrationist model is most visible where a jurisdiction can be incorporated into a European Union-centred supervisory order through sustained convergence and limited rivalry. The defensive model arises where the third country is both strategically significant and competitively threatening, requiring selective tolerance combined with efforts at gradual disengagement. The negotiationist model appears where equivalence must be worked out through bargaining between regulatory powers of comparable institutional weight. Together, these models show that equivalence is not a fixed legal category but a differentiated instrument of strategic governance.

The broader implication is that the European Union equivalence regime should be understood as part of the changing architecture of post-crisis international financial regulation. It reflects neither a purely deferential logic of mutual recognition nor a fully unilateral logic of extraterritorial control. Rather, it occupies an intermediate space in which access, supervision, co-operation and competition are continuously recalibrated.

Equivalence has thus become one of the principal mechanisms through which the European Union manages the tension between openness and control in its external financial relations.

If the regime is viewed in this way, its contribution to European Union external governance becomes clearer. Equivalence is not merely a device for recognising comparable foreign rules. It is a structured instrument through which the European Union organises differentiated forms of reliance on third-country markets and institutions, while simultaneously defending and projecting its own regulatory order. The three functional models identified in this chapter provide a more precise conceptual language for understanding that process.

CHAPTER 6: EQUIVALENCE REGIME: CHINA'S LIMITED CAPITAL MARKET AND HONG KONG'S BROKERAGE ROLE

6.1 Introduction

In an increasingly globalised financial market, the equivalence regime of the European Union (hereinafter EU) plays a central role by assessing the robustness of third country financial regulatory frameworks to ensure the safety and stability of cross-border financial services. However, when confronted with mainland China's distinct economic system and capital controls, this regime faces complex challenges. Mainland China's unique economic model – particularly its not yet fully liberalised capital account – makes it difficult for the European Union to apply its standard assessment criteria directly. As a result, the financial linkage between the European Union and mainland China exhibits an unusual and multi-layered complexity.

The central argument in this chapter is that Hong Kong, by virtue of its unique geographical, legal and financial position, has become a pivotal 'bridge' between the European Union and mainland China's financial system. This bridging role is particularly evident in the domain of stock exchange connectivity. Given the close capital linkage between Hong Kong and mainland Chinese equities, the European Union's equivalence regime has not been extended directly to the mainland market but, instead, operates indirectly through Hong Kong as a strategic intermediary. However, this model is not universally applied. In areas considered core financial infrastructure, such as central clearing, where higher standards of systemic stability and operational efficiency are required, European Union and mainland Chinese regulators have opted for direct forms of co-operation. This divergence in approach highlights the fact that the European Union does not pursue a one-size-fits-all strategy in its financial engagement with China. Rather, it adopts differentiated and flexible pathways, tailored to the specific nature of the financial service in question.

To verify and further explore this argument, this chapter begins with an analysis of the distinctive features of mainland China's economic system and the challenges it poses for international financial co-operation. The urban network theory is then introduced as an analytical framework to examine Hong Kong's unique position as a key 'node' within the

global financial network. This is followed by a comparative analysis of two concrete case studies. On the one hand, the stock exchange connectivity is examined to illustrate how the European Union leverages Hong Kong as an intermediary to achieve indirect access to the mainland Chinese market. On the other hand, the case of central clearing is explored to understand why the European Union and mainland Chinese regulators have opted for a direct co-operative arrangement in this area.

Through the juxtaposition of these two contrasting cases, the aims of this chapter are to reveal the differentiated modes of interaction between the European Union's equivalence regime and mainland China across various segments of the financial sector, ultimately offering a new perspective for understanding this complex transnational financial relationship.

6.2 Distinctive Features of China's Capital Market

6.2.1 China's Capital Market Connectivity: Specially Designed Channels

China's capital market occupies a distinctive position within the global financial system. Its institutional design is profoundly shaped by a state-led development model. Under the dual drivers of market mechanisms and national strategic objectives, China's capital market exhibits a hybrid structure that combines policy orientation with market-based features. On the one hand, the formulation of rules and the allocation of resources in securities, futures and derivatives markets remain heavily reliant on administrative direction, with regulatory authorities playing a decisive role in market access, product design and the management of cross-border capital flows. On the other hand, ongoing market-oriented reforms have brought trading systems, disclosure requirements and investor protection frameworks increasingly in line with international standards.

China's capital market operates under a foreign exchange management framework in which the capital account is not fully convertible. The renminbi has not yet achieved full convertibility, and cross-border capital flows are subject to existing foreign exchange control rules. Transactions under the capital account require approval or filing with the state foreign exchange authorities, and are constrained in terms of quota, purpose and

duration.⁵¹⁹ The absence of free convertibility of foreign currencies is the defining feature of China's capital market. Around this restriction, a series of unique and controllable channels have been designed to link domestic and international capital markets. The core principle underlying these mechanisms is one of 'limited openness and closed operation': allowing cross-border capital flows within a controlled framework, while ensuring that such flows remain transparent and traceable, thereby preventing large-scale and disorderly movements of funds from destabilising the domestic financial system.

In terms of cross-border capital flows, China has adopted a distinctive regulatory model. On the one hand, both foreign investors entering the domestic market and domestic entities investing abroad must comply with stringent entry requirements and supervisory rules. On the other hand, rather than fully liberalising the capital account, China has relied on institutional innovation to establish a series of special 'channels' linking domestic and international markets. These channels are designed not only to ensure the orderly movement of capital, but also to give regulators the capacity to monitor and, if necessary, shut down the 'valves' at any time, thereby enabling precise control and risk management of cross-border funds. As a result, there is no broad or deep integration between China's capital market and international markets; instead, the degree of economic coupling largely depends on officially designated connection points.

The connect schemes represent the most typical example of the 'channel' model. In the equity market, China has established the Shanghai–Hong Kong Stock Connect and the Shenzhen–Hong Kong Stock Connect, linking the Shanghai Stock Exchange (hereinafter SSE) and the Shenzhen Stock Exchange (hereinafter SZSE) with the Hong Kong Stock Exchange. Through these specially designed mechanisms, Hong Kong and overseas investors can trade shares listed on the Shanghai and Shenzhen exchanges via Hong Kong brokers and clearing institutions, while mainland investors can access shares listed on the Hong Kong Stock Exchange (hereinafter HKEX) through domestic brokers and clearing institutions. The connect model has been extended beyond equities to include bond trading (i.e., Bond Connect) as well as exchange-traded funds (hereinafter ETF) (i.e., ETF Connect), such as the Shenzhen–Hong Kong ETF Connect and the China–Japan ETF Connect. The most recent connect scheme, Swap Connect, has even been extended to the

⁵¹⁹ State Council of the People's Republic of China, Regulations on Foreign Exchange Administration (Decree No. 532, 2008 revision).

derivatives market. It enables foreign investors to participate in the mainland interbank derivatives market through the linkage between Hong Kong and mainland financial infrastructure institutions, initially covering interest rate swap products. This development further enhances the risk management tools available to foreign investors engaging with China's financial markets.

The sophistication of this mechanism lies in the carefully designed process of cross-border currency exchange. When mainland investors purchase Hong Kong-listed shares, they pay in renminbi; once the funds reach Hong Kong, the China Securities Depository and Clearing Corporation (hereinafter CSDC) converts them into Hong Kong dollars in the offshore renminbi market. The reverse process applies as well, with Stock Connect investors also using renminbi to purchase A-shares (i.e., ordinary shares listed on mainland Chinese exchanges and denominated in renminbi). Closed-loop management is the defining feature of these schemes. All transactions are settled through the clearing systems of both markets and cross-border fund flows are subject to strict control, ensuring that capital circulates within the system. This design minimises the impact on the onshore foreign exchange market while simultaneously strengthening Hong Kong's role as the offshore renminbi hub.

The entry of institutional investors into China's domestic capital market (through the QFII/RQFII schemes⁵²⁰) and their outward investment (through the QDII scheme⁵²¹) also reflects the principle of 'limited openness and closed operation'. First, investment quotas are subject to regulatory approval, preventing sudden inflows or withdrawals of speculative capital that could trigger sharp volatility in the domestic financial system. Second, foreign institutional investors must undergo a qualification review, ensuring that only reputable and professionally capable entities participate, thereby safeguarding compliance and financial stability. Finally, restrictions are imposed on the range of financial instruments available for trading.⁵²² This approach protects the domestic market from high-risk, highly

⁵²⁰ Qualified Foreign Institutional Investor (hereinafter QFII Regime), Renminbi Qualified Foreign Institutional Investor (hereinafter RQFII Regime).

⁵²¹ Qualified Domestic Institutional Investor (QDII Regime).

⁵²² China Securities Regulatory Commission (CSRC) Announcement No. 24 [2021] stipulates as follows:

Qualified foreign investors are newly permitted to trade commodity futures, commodity options and stock index options listed on futures exchanges approved by the State Council or the China Securities Regulatory Commission. Transactions in stock index options are restricted to hedging purposes only.

This provision exemplifies the threefold regulatory constraints imposed by Chinese authorities on foreign investors: restrictions on eligibility, eligible instruments and investment purpose.

leveraged products, while channelling foreign investment into regulator-favoured sectors, thereby ensuring that financial liberalization proceeds in line with national development strategies.

In addition, foreign companies cannot freely access the Chinese market and list their shares for trading; they must establish a local entity, namely a wholly foreign-owned enterprise. Since these entities are incorporated in China, they are subject to Chinese law, and their funds and profits cannot easily be repatriated. Moreover, they remain under the supervision and control of Chinese stock exchanges⁵²³. In general, when foreign investors seek to enter China from abroad for trading, they face additional restrictions. The opening of China's capital market has not taken the form of a 'big-bang' liberalisation; rather, it has proceeded in a highly controlled and reversible manner, with the infrastructural arrangements that permit foreign access remaining firmly embedded within the framework of capital controls.

As Johannes Petry puts it:

all other mechanisms that integrated China with global markets and enable foreign investors access – Bond Connect, (R)QFII, London–Shanghai Stock Connect, D Shares listed on CEINEX, SGE's international board or internationalised commodity contracts on SHFE, DCE and ZCE – are similarly designed to keep capital controls intact

6.2.2 China: State-Capitalist Capital Markets

According to Zhang, the legitimacy of China's leadership rests on economic growth, social stability and nationalism⁵²⁴. Thus, China's distinctive political system links the stability and security of its domestic financial markets to the legitimacy and authority of the ruling party. As a result, within China's regulatory environment, financial security is guaranteed as the overriding political priority above all else.

The 'particularity' of China's capital market stems primarily from the combined effect of its historical trajectory and the central role of the state. Emerging within a financial structure dominated by banks and characterised by extensive policy-driven credit, the capital market was from its inception entrusted with multiple objectives: serving national strategies,

⁵²³ Johannes Petry, 'Same Same, But Different: Varieties of Capital Markets, Chinese State Capitalism and the Global Financial Order' (2021) 25 *Competition & Change* 5.

⁵²⁴ Angela Huyue Zhang, 'Agility Over Stability: China's Great Reversal in Regulating the Platform Economy' (2022) 63 *Harvard International Law Journal* 409.

optimising resource allocation, advancing industrial upgrading and maintaining growth while preventing risks. This developmental model has relied on state capacity to establish foundational institutions such as exchanges, clearing and depository systems and disclosure and enforcement frameworks rapidly, while simultaneously retaining administrative control over critical stages, including issuance, pricing, leverage, refinancing and trading discipline. The result is an institutional hybrid in which policy objectives and market mechanisms operate in parallel.

Capital markets and exchanges are shaped by their institutional environments. Each country's capital market is embedded within its own distinctive economic structures, and is influenced by domestic conditions and institutions. As Petry argues, although China's capital market shares certain features with the 'global' capital market, its mode of operation is fundamentally different⁵²⁵. Rather than being neoliberal markets, China's state-owned exchange-organised capital markets are better understood as state-capitalist capital markets. This stands in contrast to the neoliberal markets that underpin the power relations within global financial organisations dominated by the United States.⁵²⁶

In China, the link between finance and politics is so deeply embedded that politics itself constitutes a core part of finance. As Heilmann notes, 'the financial industry can therefore justifiably be treated as an integral part of the political system'.⁵²⁷ In this sense, China's capital market can be understood as a site where the authorities exercise state power through financial control.⁵²⁸

The first set of restrictions lies in financial legislation. China's leadership adheres to the principle that 'finance should serve the real economy',⁵²⁹ a policy orientation that is embedded in the legislative framework to curb speculative activity. In the futures market, traders are required to declare whether their transactions are for hedging or speculative purposes and strict position limits are imposed. If an investor has already reached the position limit for speculative trading but wishes to trade additional contracts, they may

⁵²⁵ See n 5.

⁵²⁶ *ibid.*

⁵²⁷ S Heilmann S 'Regulatory Innovation by Leninist Means: Communist Party Supervision in China's Financial Industry (March 2005) *The China Quarterly* 181.

⁵²⁸ N-L Sum 'Ordoliberal Authoritarian Governance in China Since 1978: World Market, Performance Legitimacy and Biosovereign Ordering' (2019) 118 *South Atlantic Quarterly* 2.

⁵²⁹ Johannes Petry, 'Same Same, But Different: Varieties of Capital Markets, Chinese State Capitalism and the Global Financial Order (2021) 25 *Competition & Change* 5.

only do so by applying for a hedging quota tied to specific exchanges and specific contracts.⁵³⁰

Futures exchanges monitor key indicators, such as the ratio of trading volume to open interest, to determine whether illegal trading activities are taking place or whether certain products are subject to 'excessive speculation'.⁵³¹ Chinese regulators apply a principle of look-through supervision, enabling them to trace every single transaction. As they put it, 'If something happens in the market, we know who did it.' Within China's capital market, there is no space for the emergence of dark pools.⁵³² According to Zhang, in recent years Chinese leaders have become increasingly vigilant against opaque ownership structures and the regulatory arbitrage of non-financial institutions providing financial services.⁵³³ In 2023, China undertook another round of financial regulatory restructuring, establishing the National Financial Regulatory Administration, thereby further strengthening the ruling party's control over the financial sector.

In the derivatives market, the China Securities Regulatory Commission (hereinafter CSRC) Announcement No. 24 stipulates that participation in equity index options is limited to hedging purposes.⁵³⁴ When banks conduct derivatives business on behalf of clients, the former China Banking Regulatory Commission (now the National Financial Regulatory Administration) requires that banks verify the client's business conditions and transaction objectives through reviews and assessments, ensuring that such transactions are based on genuine risk management needs.⁵³⁵ Similar directives appear in the rules governing state-owned enterprises (hereinafter SOEs) engaging in overseas derivatives activities. On the one hand, China's futures and derivatives law explicitly states in its General Provisions that the state encourages the use of futures and derivatives markets for hedging and other risk

⁵³⁰ See Futures and Derivatives Law of the People's Republic of China (adopted 20 April 2022, effective 1 August 2022), Law No. 37 [2022]; China Securities Regulatory Commission (CSRC), Provisional Measures for the Administration of Futures Market Position Limits CSRC Announcement [2023] No. 49, issued 24 November 2023, effective 1 May 2024.

⁵³¹ Johannes Petry, 'Same Same, But Different: Varieties of Capital Markets, Chinese State Capitalism and the Global Financial Order' (2021) 25 *Competition & Change* 5.

⁵³² *ibid.*

⁵³³ Zhang, Angela Huyue, 'Agility Over Stability: China's Great Reversal in Regulating the Platform Economy' (2022) 63 *Harvard International Law Journal* 2.

⁵³⁴ China Securities Regulatory Commission (hereinafter CSRC), Announcement on Allowing Qualified Foreign Institutional Investors (hereinafter QFII) and RMB Qualified Foreign Institutional Investors (hereinafter RQFII) to Participate in Financial Derivatives Trading, CSRC Announcement [2021] No. 24.

⁵³⁵ Provisional Measures for the Administration of Derivatives Transactions of Banking Financial Institutions (promulgated in 2004, as amended by China Banking Regulatory Commission Order No. 1 of 2011), Art 45.

management purposes.⁵³⁶ On the other hand, the Futures Trading Regulation⁵³⁷ and relevant provisions of the State-owned Assets Supervision and Administration Commission (hereinafter SASAC)⁵³⁸ require that, unless an SOE is a licensed financial institution such as a bank, futures company, insurer or securities firm, it must adhere to the principle of hedging when engaging in futures and derivatives trading and is prohibited from engaging in any form of speculative trading. These provisions underscore the view of China's financial leadership that the use of offshore derivatives markets should primarily serve the real economy.

This provision further illustrates that in the view of China's financial leadership, the use of offshore derivatives markets should be primarily directed towards supporting the real economy. Although commercial banks may conduct client-driven transactions and engage in derivatives trading for profit-making purposes, they must first obtain approval from the former China Banking Regulatory Commission (now the National Financial Regulatory Administration) and remain subject to its supervision and inspection.

In the selection of tradable instruments, China has also demonstrated a clear tendency to restrain speculation. In the interbank market, two instruments, namely (1) the Credit Risk Mitigation Agreement (hereinafter CRMA) and (2) the Credit Risk Mitigation Warrant (hereinafter CRMW) have been introduced⁵³⁹, and are regarded as the Chinese equivalents of credit default swaps (hereinafter CDS). For CRMW issuance in the primary market, only credit protection buyers who hold the underlying bonds are entitled to hold the corresponding CRMW; in other words, the credit protection provided by CRMW is limited exclusively to the holders of the reference bonds, thereby eliminating the risk of speculative trading. Compared with CDS products in Europe and the United States, China's Credit Risk Mitigation instruments reflect a distinctly cautious approach: (1) by designating specific reference debts to ensure that credit protection is tied to particular obligations, and (2) by specifying and limiting the types of eligible reference debts.

⁵³⁶ Futures and Derivatives Law of the People's Republic of China, Art 4.

⁵³⁷ State Council of the People's Republic of China, Regulation on the Administration of Futures Trading (promulgated by State Council Decree No. 489, 6 March 2007, as amended by the Decision of the State Council on Amending the Regulation on the Administration of Futures Trading, 24 October 2012), Art 42.

⁵³⁸ State-owned Assets Supervision and Administration Commission of the State Council (hereinafter SASAC), Notice on Further Strengthening the Administration of Financial Derivatives Business (Guozi Fa Cai Ping Gui [2020] No 8, January 2020).

⁵³⁹ National Association of Financial Market Institutional Investors (NAFMII), Guidelines on the Pilot Business of Credit Risk Mitigation Instruments in the Interbank Market (issued 29 October 2010).

On the other hand, as organisers of the capital market, stock exchanges are also subject to strict government control. Both exchanges and self-regulatory organisations function as extensions of the government's supervisory arm. On the exchange side, China's major exchanges, such as the SSE, the SZSE and the China Financial Futures Exchange, were not established and developed entirely through spontaneous market forces, but rather through state-led top-level design. Their initial establishment carried explicit political and economic tasks aimed at serving national development strategies. The appointment of their leadership is usually determined by the government authorities concerned, and their senior managers often have strong administrative backgrounds. This gives the internal management and decision-making processes of the exchanges a distinct administrative character, making them operate more like quasi-governmental institutions with public service functions than purely commercial companies.

Exchanges, as the 'front-line regulators' of the capital market, possess the authority to supervise listed companies on a daily basis, monitor trading activities in real time and enforce self-regulatory measures against misconduct. These functions derive directly from the authorisation of national laws and regulations, and operate in close coordination with the supervisory framework of the CSRC.⁵⁴⁰ Exchanges serve as key platforms for the implementation and execution of CSRC policies. Whether it is the reform of the initial public offering (hereinafter IPO) system (such as the registration-based regime), the adjustment of trading rules, or the improvement of the delisting mechanism, exchanges are directly responsible for carrying out the specific implementation work. In many cases, the business rules and guidelines of the exchanges represent the concretisation and refinement of the CSRC's macro-level policies.

In times of abnormal market volatility, exchanges often co-operate with regulatory authorities to introduce measures such as adjusting transaction fees or restricting certain trading activities in order to maintain market stability. These actions often carry the character of macro-level regulation rather than being driven purely by commercial interests.⁵⁴¹

⁵⁴⁰ China Securities Regulatory Commission, Measures for the Administration of Stock Exchanges (promulgated 30 November 2019, effective 1 February 2020).

⁵⁴¹ See, for example, Mingying Cheng, Ling Jin, Zhisheng Li and Bingxuan Lin, 'The Effectiveness of Government Stock Purchase during Market Crash: Evidence from China' (2022) 71 *Pacific-Basin*

Although exchanges are vested with the function of 'self-regulation', this self-regulation operates within the overarching supervisory framework of the CSRC. Any major rule changes or business adjustments by the exchanges must obtain the approval of the CSRC.⁵⁴² This relationship makes the self-regulation of exchanges essentially an effective extension of the CSRC's regulatory system.

China's largest over-the-counter (hereinafter OTC) market is the interbank market, which is composed of institutional investors, including policy banks, commercial banks, securities firms, trust companies, investment funds, and large and medium-sized industrial and commercial enterprises, among other financial and non-financial institutions.⁵⁴³ As the largest and most important OTC trading network, this market is subject to self-regulation by the National Association of Financial Market Institutional Investors (hereinafter NAFMII), which operates under the People's Bank of China (hereinafter PBoC; the central bank). In practice, the association is guided and administratively led by the PBoC, which assists the central bank in performing its macro-prudential regulatory function.⁵⁴⁴

In fact, the creation of the interbank market self-regulatory association originated from a controversy over the boundaries of the administrative powers of the PBoC. In 2005, after the central bank had decided to implement market-based issuance of short-term financing bills, the Legislative Affairs Office of the State Council sent an inquiry letter questioning whether it was appropriate for the central bank, as the monetary authority, to intervene directly in the management of the bond market. The final outcome of this controversy was that the PBoC decided to establish a self-regulatory organisation independent of government institutions to assume the bond issuance functions previously carried out by its Financial Markets Department. Against this backdrop, the NAFMII was founded in 2007. From its founding team to its management staff, most of its personnel came from the PBoC's Financial Markets Department, which had previously been responsible for the bond market.⁵⁴⁵ It can thus be seen that the self-regulation of the interbank market is, in fact, subject to the control of administrative bureaucracy. Moreover, the major institutional

Finance Journal 101706.

⁵⁴² China Securities Regulatory Commission, Measures for the Administration of Stock Exchanges (promulgated 30 November 2019, effective 1 February 2020).

⁵⁴³ National Association of Financial Market Institutional Investors (NAFMII), About NAFMII <<https://www.nafmii.org.cn/ljxh/xhjs/index.html>>

⁵⁴⁴ Ibid.

⁵⁴⁵ Sina Finance, 'The Real Boss of the Bond Market: The Rights and Wrongs of NAFMII', Sina Finance (8 October 2018) <<https://finance.sina.cn/bond/zsyw/2018-10-09/detail-ihkvrhpt0801210.d.html>>

participants in the interbank market, which command substantial financial resources, are often state-owned enterprises under the supervision of SASAC. In the context of OTC trading, which is otherwise characterised by greater freedom, the involvement of large-scale capital flows and state-owned assets has led China to adopt a particularly stringent regulatory approach in the interbank market, primarily out of considerations of financial stability.

China's domestic financial market continues to evolve along a distinct trajectory different from that of liberal Western financial markets, which creates various challenges and constraints⁵⁴⁶ for listed companies and investors, and gives prominence to Hong Kong's status as an intermediary.⁵⁴⁷ The contemporary global financial system is essentially built upon the structural power of the United States in monetary and financial affairs.⁵⁴⁸ On the one hand, China has consistently mobilised state intervention tools domestically to resist this hegemonic order.⁵⁴⁹ On the other hand, over the past decades China has benefited significantly from Western-led globalisation, with its economy intrinsically connected to contemporary global integration and foreign capital.⁵⁵⁰

In summary, at the international level, China's capital market is continually enhancing its compatibility with global regulatory frameworks through connectivity mechanisms; co-operation in accounting and auditing supervision; clearing and custody arrangements; and the gradual convergence of trading rules and disclosure requirements. At the same time, however, China continues to adhere to an independent development path, maintaining tight control over its capital market in sharp contrast to the prevailing models of the European Union and the United States. Within the framework of limited openness, China places

⁵⁴⁶ Ilias Alami and Adam D. Dixon, 'The Strange Geographies of the "New" State Capitalism' (2020) 82 *Political Geography* 102237. Johannes Petry, 'Same Same, but Different: Varieties of Capital Markets, Chinese State Capitalism and the Global Financial Order' (2021) 25(5) *Competition & Change* 605.

⁵⁴⁷ Y-W Vincent Li, 'Hong Kong in China's Financial Globalization: Market Power and Political Leverage' (2018) 58 *Asian Survey*; Yu-wai Vic Li, 'The Irreplaceable Outpost? Whither Hong Kong in China's Financial Future' (2020) 20 *China Review* 261.

⁵⁴⁸ Patrick Emmenegger, 'The Long Arm of Justice: US Structural Power and International Banking' (2015) 17(3) *Business and Politics* 473; Shaina Potts, 'Law as Geopolitics: Judicial Territory, Transnational Economic Governance and American Power' (2020) 110(4) *Annals of the American Association of Geographers* 1192.

⁵⁴⁹ Johannes Petry, 'Same Same, but Different: Varieties of Capital Markets, Chinese State Capitalism and the Global Financial Order' (2021) 25(5) *Competition & Change* 605.

⁵⁵⁰ Seth Schindler, Jamie DiCarlo and Dibyendu Paudel, 'The New Cold War and the Rise of the 21st Century Infrastructure State' (2021) 47 *Transactions of the Institute of British Geographers*.

particular emphasis on retaining autonomous control over key segments. Against this backdrop, Hong Kong has emerged as an important buffer zone.⁵⁵¹

6.3 Global Financial Networks and Brokerage Cities: Why Hong Kong Serves as a Conduit Between Mainland China and Global Capital

China has been steadily integrating into global financial markets, and throughout this process Hong Kong has served as a crucial intermediary between China and the international financial system, particularly with regard to capital markets.⁵⁵² This reflects its distinctive position in relation to mainland China.⁵⁵³

The concept of *global financial networks* (hereinafter GFNs) originates in economic geography, and is defined as the networks that link financial centres, offshore jurisdictions and the rest of the world through finance and advanced business services (hereinafter FABS) and their activities.⁵⁵⁴ This perspective transforms the intangible space of finance into a tangible network structured around actual financial jurisdictions and key financial cities, interconnected on a global scale.⁵⁵⁵ Emerging alongside the study of GFNs are brokerage cities,⁵⁵⁶ which arose with the advance of economic globalisation.

The role of the broker arises from the various barriers that exist in international financial markets, such as regional market fragmentation, geopolitical factors, cultural differences

⁵⁵¹ Ibid

⁵⁵² Karen PY Lai, 'Differentiated Markets: Shanghai, Beijing and Hong Kong in China's Financial Centre Network' (2012) 49 *Urban Studies*; David R. Meyer, 'Hong Kong, Shanghai and Beijing: China's Contenders for Global Financial Centre Leadership' in Youssef Cassis and Dariusz Wójcik (eds), *International Financial Centres after the Global Financial Crisis and Brexit* (Oxford University Press 2018) 126–153.

⁵⁵³ *ibid*; Pan Fenghua, He Ziyun, Fang Chuanglin, Yang Bo and Liang Jian, 'World City Networks Shaped by the Global Financing of Chinese Firms: A Study Based on Initial Public Offerings of Chinese Firms on the Hong Kong Stock Exchange, 1999–2017' (2018) 18(3) *Networks and Spatial Economics* 751; Bas Karreman and Bert van der Knaap, 'The Geography of Equity Listing and Financial Centre Competition in Mainland China and Hong Kong' (2012) 12(4) *Journal of Economic Geography* 899.

⁵⁵⁴ Neil M Coe, Karen PY Lai and Dariusz Wójcik, 'Integrating Finance into Global Production Networks' (2014) 48(5) *Regional Studies* 761.

⁵⁵⁵ Dariusz Wójcik, 'The Global Financial Networks' in Gordon L Clark, Maryann P Feldman, Meric S Gertler and Dariusz Wójcik (eds), *The New Oxford Handbook of Economic Geography* (Oxford University Press 2018) 557.

⁵⁵⁶ Kirsten Martinus, Thomas Sigler, Iacopo Iacopini and Ben Derudder, 'The Brokerage Role of Small States and Territories in Global Corporate Networks' (2021) 52(1) *Growth and Change* 12; Thomas Sigler, Zachary P Neal and Kirsten Martinus, 'The Brokerage Roles of City-Regions in Global Corporate Networks' (2023) 57(2) *Regional Studies* 239.

and divergent levels of economic development,⁵⁵⁷ which generate the need for intermediaries to facilitate transactions between otherwise disconnected parties.⁵⁵⁸ With the advance of economic globalisation, cities and regions have begun to assume similar brokerage functions, mediating across diverse markets and serving as channels of communication. Specific cities or regions, such as financial centres and offshore jurisdictions, can, through global corporate activities and the associated flows of capital, develop into critical nodes of command and control in the world economy.⁵⁵⁹ The economic linkages among these cities form a world city network,⁵⁶⁰ through which global value transfer is realised.⁵⁶¹

Within global financial networks, these nodes play a distinctive intermediary role between economies of different scales and/or among different regions within the same economy, thereby forging connections with the highly integrated global financial market.⁵⁶² Hong Kong is a particularly typical example of a brokerage city. As an influential global financial centre, Hong Kong possesses strategic advantages in attracting global financial services firms.⁵⁶³

From a network perspective, Hong Kong demonstrates a high level of connectivity, both globally and in relation to New York; the core of the network. From a geographical perspective, Hong Kong is situated in close proximity to mainland China, with deep historical, political and regulatory ties to it, while at the same time operating under a distinct capitalist economic system. This unique combination makes Hong Kong a special

⁵⁵⁷ Cheng Fang, Fenghua Pan and Karen PY Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57(2) *Regional Studies* 317.

⁵⁵⁸ Peter Marsden, 'Brokerage Behavior in Restricted Exchange Networks' in Peter Marsden and Nan Lin (eds), *Social Structure and Network Analysis* (SAGE 1982).

⁵⁵⁹ John Friedmann and Goetz Wolff, 'World City Formation: An Agenda for Research and Action' (1982) 6 *International Journal of Urban and Regional Research*. Saskia Sassen, *The Global City: New York, London, Tokyo* (Princeton University Press 1991).

⁵⁶⁰ Peter J Taylor and Ben Derudder, *World City Network: A Global Urban Analysis* (2nd edn, Routledge 2015).

⁵⁶¹ Ben Derudder and Peter J. Taylor, 'Central Flow Theory: Comparative Connectivities in the World-City Network' (2018) 52(8) *Regional Studies* 1029; Christoph Parnreiter, 'Global Cities and the Geographical Transfer of Value' (2019) 56(1) *Urban Studies* 81; Peter J. Taylor, Ben Derudder, James Faulconbridge, Michael Hoyler and Pengfei Ni, 'Advanced Producer Service Firms as Strategic Networks, Global Cities as Strategic Places' (2014) 90(3) *Economic Geography* 267.

⁵⁶² Cheng Fang, Fenghua Pan and Karen PY Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57(2) *Regional Studies* 317.

⁵⁶³ Pan Fenghua et al, 'How Chinese Financial Centers Integrate into Global Financial Center Networks: An Empirical Study Based on Overseas Expansion of Chinese Financial Service Firms' (2018) 28 *Chinese Geographical Science* 217–230.

linkage point between mainland China and the Western financial system.⁵⁶⁴ In other words, as an important node in the global financial network, Hong Kong is both a world-leading international financial centre and an offshore jurisdiction under China's control. This gives it the distinctive character of a mid-shore financial centre.⁵⁶⁵

From the perspective of Hong Kong's geographical background, its brokerage role within GFNs can be explained from the following aspects.

First, owing to its economic system, Hong Kong enjoys a special position in linking the Western-dominated global financial system with mainland China, which occupies a peripheral position in that system. Even during the colonial period from 1842 to 1997, Hong Kong's economic ties with the mainland never diminished. For Western capital, Hong Kong has served as a convenient gateway for expanding into Asian markets, particularly the mainland Chinese market. For mainland China, Hong Kong's proximity to the core of the global financial system has provided its financial markets and institutions with significant opportunities and models from which to learn.⁵⁶⁶ As a result, Hong Kong has become both a transshipment hub for Western financial capital seeking profits in the mainland and a bridge for the mainland to enter the core global financial markets.

Because mainland China lacked a mature and efficient domestic capital market at the end of the twentieth century,⁵⁶⁷ the process of reform and opening-up, attracting foreign investment and promoting market-oriented reform was, to a large extent, driven by overseas financial centres, and by financial and securities firms embedded in global financial networks.⁵⁶⁸ By injecting the necessary capital and expertise into mainland China, these regions facilitated its development⁵⁶⁹ and gradual integration into global financial networks, making it an important jurisdiction in the world economy. In this process, Hong Kong has played a particularly important brokerage role as the primary destination for

⁵⁶⁴ Cheng Fang, Fenghua Pan and Karen PY Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57(2) *Regional Studies* 317.

⁵⁶⁵ *ibid.*

⁵⁶⁶ Karen PY Lai, 'Marketization Through Contestation: Reconfiguring China's Financial Markets Through Knowledge Networks' (2011) 11(1) *Journal of Economic Geography* 87.

⁵⁶⁷ Carl Walter and Fraser Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise* (Wiley 2012).

⁵⁶⁸ Dariusz Wójcik and Joseph Camilleri, "'Capitalist Tools in Socialist Hands'?: China Mobile in Global Financial Networks' (2015) 40(4) *Transactions of the Institute of British Geographers* 464.

⁵⁶⁹ Fenghua Pan, Chunguang Yang, Haixiao Wang and Dariusz Wójcik, 'Linking Global Financial Networks with Regional Development: A Case Study of Linyi, China' (2020) 54(2) *Regional Studies* 187.

mainland Chinese companies seeking overseas listings. As a listing venue, Hong Kong hosts the largest number of overseas-listed mainland firms and the HKEX has helped a vast number of Chinese companies raise capital from international markets.⁵⁷⁰

At the same time, Hong Kong has also provided a full range of services through Hong Kong-based FABS firms, facilitating the further overseas listings of Chinese companies on other international stock exchanges.⁵⁷¹ On this point, Wójcik and Camilleri⁵⁷² have discussed in detail how Hong Kong, through its competitive financial and accounting systems, and its offshore character, plays an important intermediary role between mainland China and global financial markets.

Second, Hong Kong has established strong global network linkages with other major international financial centres.⁵⁷³ From the perspective of global financial centre networks, it is the inter-city FABS co-operation networks that enable financial centre cities to play intermediary roles both globally and locally. New York accounts for 56.0% of total inter-city FABS co-operation, ranking first, while Hong Kong ranks second with 30.4%. Co-operation between New York and Hong Kong alone represents 13.3%. This indicates that the network positions of New York and Hong Kong, as well as the FABS connections between the two cities, form an important structural component of the network.⁵⁷⁴

Third, owing to its geographical advantage, Hong Kong holds a privileged position in linking China with major international financial markets; a role as a brokerage city that has been recognised by both Western economies and China. For a long time, Western international

⁵⁷⁰ Bas Karreman and Bert van der Knaap, 'The Geography of Equity Listing and Financial Centre Competition in Mainland China and Hong Kong' (2012) 12 *Journal of Economic Geography*; Fenghua Pan and David Brooker, "'Going Global'?: Examining the Geography of Chinese Firms' Overseas Listings on International Stock Exchanges' (2014) 52 *Geoforum*; Fenghua Pan, et al, 'World City Networks Shaped by the Global Financing of Chinese Firms: A Study Based on Initial Public Offerings of Chinese Firms on the Hong Kong Stock Exchange, 1999–2017' (2018) 18 *Networks and Spatial Economics*.

⁵⁷¹ Cheng Fang, Fenghua Pan and Karen P. Y. Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57 *Regional Studies*

⁵⁷² Dariusz Wójcik and Joseph Camilleri, "'Capitalist Tools in Socialist Hands'?: China Mobile in Global Financial Networks' (2015) 40 *Transactions of the Institute of British Geographers*.

⁵⁷³ Jonathan V Beaverstock, Richard G Smith and Peter J Taylor, 'A Roster of World Cities' (1999) 16 *Cities*; Ben Derudder and Peter J. Taylor, 'Three Globalizations Shaping the Twenty-First Century: Understanding the New World Geography through Its Cities' (2020) 110 *Annals of the American Association of Geographers*; Peter J Taylor, Ben Derudder, James Faulconbridge, Michael Hoyler and Pengfei Ni, 'Advanced Producer Service Firms as Strategic Networks, Global Cities as Strategic Places' (2014) 90 *Economic Geography*.

⁵⁷⁴ Cheng Fang, Fenghua Pan and Karen PY Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57 *Regional Studies*.

financial institutions have made Hong Kong a key locational strategy within the global financial network,⁵⁷⁵ establishing branches of major financial firms such as investment banks and accounting firms in the city. At the same time, for Chinese companies, Hong Kong serves as a platform to learn how to engage with foreign enterprises, with many firms setting up their first overseas office there.⁵⁷⁶ On the regulatory side, both the Hong Kong Special Administrative Region (hereinafter SAR) government and relevant mainland authorities have reached consensus on positioning Hong Kong as the gateway for foreign capital entering the mainland.⁵⁷⁷ This is reflected in Hong Kong's light-touch regulation, business-friendly tax policies and various preferential measures to strengthen economic ties between Hong Kong and the mainland.⁵⁷⁸ While mainland financial centres still significantly restrict foreign market participation, Hong Kong is the only Chinese financial centre with a fully open capital account. In the light of this, the central government has introduced corresponding preferential policies to facilitate the flow of Hong Kong capital into the mainland. For example, in the latest Guangdong–Hong Kong–Macao Greater Bay Area development plan, the central government pledged to support Hong Kong's status as an international financial centre, and to promote co-operation between mainland cities and Hong Kong in offshore financial services.⁵⁷⁹

Fourth, Hong Kong's colonial history has left it with institutional and cultural legacies that closely resemble Western models, including a free market economy, liberal foreign exchange controls and an environment favourable to English speakers in terms of language and business culture.⁵⁸⁰ Early studies emphasised the fact that overseas listings required specialised expertise in accounting and financial systems from both the home and host

⁵⁷⁵ David R Meyer, 'Hong Kong, Shanghai and Beijing: China's Contenders for Global Financial Centre Leadership' in Youssef Cassis and Dariusz Wójcik (eds), *International Financial Centres after the Global Financial Crisis and Brexit* (Oxford University Press 2018); Catherine R Schenk, 'Banks and the Emergence of Hong Kong as an International Financial Center' (2002) 12 *Journal of International Financial Markets, Institutions and Money*.

⁵⁷⁶ Fenghua Pan, Ziyun He, Thomas Sigler, Kirsten Martinus and Ben Derudder, 'How Chinese Financial Centers Integrate into Global Financial Center Networks: An Empirical Study Based on Overseas Expansion of Chinese Financial Service Firms' (2018) 28 *Chinese Geographical Science*.

⁵⁷⁷ Y-W Vincent Li, 'Hong Kong in China's Financial Globalization: Market Power and Political Leverage' (2018) 58 *Asian Survey*; Y-W Vincent Li, 'The Irreplaceable Outpost? Whither Hong Kong in China's Financial Future' (2020) 20 *China Review*.

⁵⁷⁸ Cheng Fang, Fenghua Pan and Karen P Y Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57 *Regional Studies*.

⁵⁷⁹ Jamie Peck, 'On Capitalism's Cusp' (2021) 6 *Area Development and Policy*.

⁵⁸⁰ Carmen B Ramón-Berjano, Simon X Zhao and Cecilia Y Ming, 'Hong Kong's Transformation into a Service Hub: Regional Development Within 'One Country, Two Systems' (2011) 51 *Asian Survey*; David R Meyer, 'Hong Kong, Shanghai and Beijing: China's Contenders for Global Financial Centre Leadership' in Youssef Cassis and Dariusz Wójcik (eds), *International Financial Centres after the Global Financial Crisis and Brexit* (Oxford University Press 2018).

countries, due to regulatory requirements and local knowledge.⁵⁸¹ As a former British colony, Hong Kong established regulatory and legal frameworks, as well as a business and financial environment aligned with Western standards.⁵⁸² While China has signed comprehensive trade agreements with most major economies worldwide, these countries do not share the same regulatory environment as Hong Kong, which features light-touch corporate regulation, a simple tax regime and low tax rates.⁵⁸³

As China has increasingly integrated into the global financial system, major financial cities such as Beijing and Shanghai have also emerged on the mainland. Yet within the urban financial network, these cities have not developed a competitive relationship with Hong Kong, but rather a complementary one. In this network, a distinctive pattern has taken shape: Shanghai functions as the commercial centre, Beijing as the political centre and Hong Kong as the offshore financial centre.⁵⁸⁴

Beijing, as China's political centre, possesses unique political advantages unmatched by other cities, which sets it apart from those oriented primarily towards finance and commerce. Shanghai and Hong Kong both serve as commercial centres, yet their relationship is not one of simple competition, but rather of complementarity and mutual advancement. This is reflected mainly in the following aspects:

First, international financial firms exhibit pronounced geographic and sectoral clustering,⁵⁸⁵ which drives them to concentrate in different financial and economic cities. Studies of companies listed on the SSE and the HKEX show that smaller local firms are mainly listed on the SSE, while the HKSE attracts larger international firms. Moreover, firms listed on the SSE are primarily concentrated in primary industries and heavy industries, whereas those listed on the HKSE are mainly in information- and knowledge-

⁵⁸¹ Dariusz Wójcik, *The Global Stock Market: Issuers, Investors and Intermediaries in an Uneven World* (Oxford University Press 2011).

⁵⁸² David R. Meyer, 'Hong Kong, Shanghai and Beijing: China's Contenders for Global Financial Centre Leadership' in Youssef Cassis and Dariusz Wójcik (eds), *International Financial Centres after the Global Financial Crisis and Brexit* (Oxford University Press 2018); JJ Woo, *Business and Politics in Asia's Key Financial Centres: Hong Kong, Singapore and Shanghai* (Springer 2016); Steve Tsang, *A Modern History of Hong Kong* (IB Tauris 2004).

⁵⁸³ Gordon L Clark, Karen PY Lai and Dariusz Wójcik, 'Editorial Introduction to the Special Section: Deconstructing Offshore Finance' (2015) 91 *Economic Geography*.

⁵⁸⁴ David R Meyer, 'Hong Kong, Shanghai and Beijing: China's Contenders for Global Financial Centre Leadership' in Youssef Cassis and Dariusz Wójcik (eds), *International Financial Centres after the Global Financial Crisis and Brexit* (Oxford University Press 2018).

⁵⁸⁵ Bas Karreman and Bert van der Knaap, 'The Financial Centres of Shanghai and Hong Kong: Competition or Complementarity?' (2009) 41 *Environment and Planning A*.

intensive sectors. From this it can be concluded that the two exchanges demonstrate significant complementarity in their stock markets rather than evolving as close substitutes.⁵⁸⁶

Second, although the mainland banking sector has developed rapidly over the past two decades, significant differences remain between the regulatory structures of Shanghai and Hong Kong, resulting in sharply contrasting business environments. In particular, foreign banks still face substantial regulatory restrictions in the mainland regarding operating licences and foreign exchange, which limit the range of financial products and services they can offer.⁵⁸⁷ Almost all foreign banks have emphasised the non-convertibility of the renminbi. In theory, foreign banks could transfer funds from their headquarters or branches elsewhere in the region (e.g., Hong Kong or Singapore) to support their operations and expansion plans in China. In practice, however, these banks are subject to annual foreign exchange quotas, which restrict their activities in the mainland. Some of the respondents interviewed for the study noted that in order not to exceed these quotas, they had to turn down business opportunities on the mainland.⁵⁸⁸

To cope with these annual quotas, many foreign banks conduct their transactions through their Hong Kong offices, where such currency restrictions do not exist. Hong Kong's advantageous location, its extensive experience in China-related business, and its expertise in financial and legal services mean that it is well positioned to provide such offshore services. As a result, even if actual business transactions cannot be carried out in Shanghai due to quota limitations, the deals are not lost, since services can still be provided to the mainland market from Hong Kong.⁵⁸⁹

From the perspective of global financial centre networks, it is the inter-city FABS co-operation networks that enable financial centres to perform intermediary roles at both global and local levels.⁵⁹⁰ As parallel markets, Shanghai and Hong Kong employ spatial

⁵⁸⁶ Karen Lai, 'Differentiated Markets: Shanghai, Beijing and Hong Kong in China's Financial Centre Network' (2012) 49 *Urban Studies*.

⁵⁸⁷ *ibid.*

⁵⁸⁸ *ibid.*

⁵⁸⁹ *ibid.*

⁵⁹⁰ Cheng Fang, Fenghua Pan and Karen PY Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57 *Regional Studies*

arbitrage strategies, resulting in roles that are functionally different yet mutually dependent in their relationship.⁵⁹¹

In the early stages of China's capital market development, mainland enterprises issuing overseas bonds to foreign investors or pursuing overseas listings often did so by establishing subsidiaries in Hong Kong. As one of the world's three major financial centres (alongside New York and London), Hong Kong has effectively functioned as a special springboard and testing ground between mainland China and international capital markets. It has long been a key destination for Chinese companies seeking overseas listings. At the same time, when setting up special purpose vehicles (hereinafter SPVs) through variable interest entity (hereinafter VIE) structures, the financial capital raised by mainland enterprises typically flows through several offshore jurisdictions before returning to the issuer's location.⁵⁹² In this model as well, Hong Kong serves as an important base for establishing SPVs, consistently acting as a gateway linking onshore mainland enterprises with offshore capital networks.⁵⁹³

Hong Kong is also the principal offshore renminbi settlement centre. The increasing use of the renminbi in reserves is considered a strategic move on the part of the Chinese authorities, aiming to provide new policy options for foreign governments and investors, and to enhance economic autonomy by moving away from the US dollar-dominated monetary system.⁵⁹⁴ OTC Clear is a clearing house recognised under section 37 of Hong Kong's Securities and Futures Ordinance and is the first international clearing house to provide clearing services for US dollar/offshore renminbi cross-currency swaps (hereinafter CCS). It has also been recognised by the ESMA as a third country CCP, allowing clearing houses located outside the European Union to provide clearing services to certain European financial institutions. In addition, OTC Clear has obtained an

⁵⁹¹ Karen Lai, 'Differentiated Markets: Shanghai, Beijing and Hong Kong in China's Financial Centre Network' (2012) 49 *Urban Studies*.

⁵⁹² Peter J Buckley, Dylan Sutherland, Hinrich Voss and Amira El-Gohari, 'The Economic Geography of Offshore Incorporation in Tax Havens and Offshore Financial Centres: The Case of Chinese MNEs' (2015) 15 *Journal of Economic Geography*; Daniel Haberly and Dariusz Wójcik, 'Regional Blocks and Imperial Legacies: Mapping the Global Offshore FDI Network' (2015) 91 *Economic Geography*.

⁵⁹³ Cheng Fang, Fenghua Pan and Karen PY Lai, 'The Brokerage Role of Hong Kong in Global Financial Networks: The Case of Mainland Chinese Companies' US Listings' (2023) 57 *Regional Studies*.

⁵⁹⁴ Gregory Chin, 'China's Rising Monetary Power' in Eric Helleiner and Jonathan Kirshner (eds), *The Great Wall of Money: Power and Politics in China's International Monetary Relations* (Cornell University Press 2014); Jonathan Kirshner, 'Regional Hegemony and an Emerging RMB Zone' in Eric Helleiner and Jonathan Kirshner (eds), *The Great Wall of Money: Power and Politics in China's International Monetary Relations* (Cornell University Press 2014).

exemption from registration as a derivatives clearing organisation hereinafter DCO) (i.e., exempt DCO status) from the US Commodity Futures Trading Commission, (hereinafter CFTC), permitting it to admit US banks as clearing members.

Building on these structural advantages, Hong Kong does not merely serve as a conduit for capital flows but also as a functional extension of mainland China's financial presence in global markets. Exchanges in Hong Kong provide the principal venue for overseas listings of Chinese firms and operate as the main offshore platform through which international investors can access Chinese securities under a stable and recognisable legal framework. For the European Union, this intermediary function has been decisive: while equivalence with mainland China's closed equity market is not feasible, Hong Kong offers a legally recognisable and operationally reliable gateway. It is in this context that the Commission granted Hong Kong limited equivalence for the stock trading obligation, treating its exchanges as a functional bridge between European markets and Chinese capital flows.

6.4 The Underlying Considerations Behind Hong Kong's Share Trading Obligation Equivalence Recognition

Under MiFID II (hereinafter Markets in Financial Instruments Directive)/ Markets in Financial Instruments Regulation (hereinafter MiFIR), if a stock exchange has not obtained an EU equivalence decision, EU investment firms are prohibited from trading EU shares on that venue. This has implications for dual-listed stocks, as the absence of equivalence restricts EU firms from accessing those markets(See further discussion in Chapter 3)

Hong Kong has obtained one of the very few equivalence decisions in relation to the Share Trading Obligation (hereinafter STO),⁵⁹⁵ whereas the mainland Chinese stock exchanges (i.e., the Beijing Stock Exchange, the SSE and the SZSE) have not received STO recognition. Given the closed nature of the mainland equity market, this outcome is entirely reasonable.

China has long been exploring direct connectivity between mainland exchanges and their European counterparts. For example, the SSE, Deutsche Börse and the China Financial

⁵⁹⁵ European Commission, Commission Implementing Decision (EU) 2017/2319 of 13 December 2017 on the Equivalence of the Legal and Supervisory Framework Applicable to Recognised Exchange Companies in Hong Kong Special Administrative Region in Accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L311/62.

Futures Exchange jointly established the China Europe International Exchange, which primarily lists renminbi-denominated financial products such as ETFs, bonds and derivatives. In essence, it serves as a channel for 'Chinese capital going global', thereby facilitating the internationalisation of renminbi assets.

China has also experimented with using depositary receipts as a two-way channel for China–Europe connectivity.⁵⁹⁶ Through this mechanism, Chinese A-share companies can issue GDRs on the Swiss and German exchanges,⁵⁹⁷ whereas the reverse arrangement (i.e., European firms issuing CDRs in Shanghai) has so far seen little substantive implementation.

Because the European Union's STO obligation applies to EU shares and on mainland China, the Shanghai and SZSEs limit trading to domestically issued and approved renminbi-denominated common shares (A-shares), certain foreign-targeted shares (B-shares) and a small number of approved Chinese depositary receipts, there is currently no mechanism allowing EU companies' domestically issued shares to be directly listed on the SSE or SZSE. Within this institutional framework, even if the STO rules were considered, their scope of application would be extremely limited due to the absence of offshore share liquidity with which to connect. By contrast, Hong Kong occupies a different position: as a convergence point between the mainland and international capital markets, it provides both the institutional framework and the liquidity base for cross-border equity investment.

European Union investment firms are permitted to trade EU shares directly in Hong Kong, which brings additional trading volume and capital inflows to the Hong Kong Stock Exchange. At the same time, under the design of the Shanghai–Hong Kong and Shenzhen–Hong Kong Stock Connect schemes, the range of eligible stocks is dynamically adjusted based on criteria such as market capitalisation, liquidity and dual listing status across the two markets. If more EU company shares become actively traded in Hong Kong as a result of equivalence recognition, they may qualify for inclusion under Stock Connect. Consequently, the European Union's STO equivalence granted to Hong Kong not only benefits the Hong Kong market itself but also provides investors in Hong Kong and across

⁵⁹⁶ China Securities Regulatory Commission (CSRC), Provisions on the Administration of Depositary Receipt Business Under the Interconnection Mechanism between Domestic and Overseas Stock Exchanges, CSRC Announcement [2022] No. 28.

⁵⁹⁷ Shi Jing and Jiang Xueqing, 'Tapping into European Markets via GDRs,' China Daily (Global Edition), 30 May 2022, <Tapping into European markets via GDRs - Chinadaily.com.cn>

Asia with a more convenient channel to participate in European markets, thereby enhancing liquidity and market activity in Hong Kong.

In theory, such mutual recognition would position Hong Kong as the preferred platform in Asia for trading European stocks. Investors would no longer need to go through exchanges in London, Frankfurt or other European centres, but could complete transactions directly in Hong Kong. This significantly reduces transaction costs and time differences, thereby enabling Hong Kong to emerge as Asia's trading hub for European equities. At the same time, such mutual recognition further strengthens Hong Kong's role as the 'super connector' between mainland China and the world. It is not only a bridge linking the mainland with international markets, but also a hub connecting different regions and financial systems. Through Hong Kong, mainland capital can also gain more convenient access to European markets.

6.5 Direct Equivalence for Mainland China in Derivatives Central Clearing: Global Connectivity and Systemic Importance

In traditional financial terminology, futures are a standardised form of forward contract and thus a subset of derivatives; in other words, futures have conventionally been regarded as one type of derivative. However, with the adoption of the Futures and Derivatives Law in 2023, China placed futures and derivatives side by side, thereby establishing in its legal classification that derivatives trading and futures trading correspond respectively to OTC and exchange trading. This legislative choice of terminology reflects the divergences in technical legal language that arise across jurisdictions, even amid ongoing processes of international convergence.⁵⁹⁸

Because of its distinctive institutional environment, China's futures and derivatives markets have consistently focused on commodity futures.⁵⁹⁹ This focus is not only intended to better serve the real economy, but also to expand the role of the renminbi in the global

⁵⁹⁸ Yan Liu, 'From Contract Governance to Commercial Law Governance: A Brief Review of China's Legal Innovation in Admitting OTC Derivatives' (2022) (103) *Tsinghua Financial Review* 79.

⁵⁹⁹ For example, in its official press release, the CSRC explicitly stated that the Futures and Derivatives Law of the People's Republic of China primarily regulates the futures market, while also taking into account the derivatives market more broadly. The CSRC particularly emphasised the need to strengthen the functions of the futures market and enhance its capacity to serve the real economy. It also highlighted the importance of promoting the development of agricultural futures and derivatives markets through dedicated measures. For further details on the CSRC, see website: <<http://www.csrc.gov.cn/csrc/c100028/c2346672/content.shtml>>

commodity pricing system. By enhancing the renminbi's influence in commodity futures pricing, China seeks to safeguard the stable supply of international commodities, which is regarded as an important national political and economic strategy.

In contrast, the OTC derivatives market in Mainland China, for example, interest rate swaps, remains relatively small in scale, with both investor eligibility and product scope subject to strict restrictions. In particular, OTC derivatives in the interbank market are mainly participated in by a limited set of large financial institutions, such as state-owned banks and major insurance companies. This model resembles a 'whitelist' system, where only core institutions meeting stringent entry requirements are permitted to take part. Such a cautious development strategy is consistent with China's overarching philosophy of strict control over financial risk.

The European Union's equivalence regime in the field of financial services, in turn, still primarily focuses on derivatives-related services; for example, the European Union's equivalence assessment of 'trading venues' centres on evaluating whether the platforms on which derivatives contracts are traded comply with EU standards.

China's relatively limited derivatives market in terms of scale and stage of development largely explains why, despite being the world's second-largest economy, it features only sparingly in the European Union's equivalence framework and has obtained equivalence recognition in relatively few areas. In short, differences in market focus and the degree of openness in derivatives markets between the two sides have directly shaped China's level of participation and the scope of mutual recognition under the EU equivalence regime.

To date, most of the European Union's equivalence decisions concerning China have focused on general-purpose areas such as transparency-reporting exemptions within central bank networks and risk-weight relief. The only specific financial sector in which the European Union has granted an equivalence decision to China's regulatory framework is in relation to the recognition of the Shanghai Clearing House as a CCP. This also reflects the distinctiveness of central counterparties.

The Shanghai Clearing House, established in 2009, did not obtain equivalence recognition until 2022,⁶⁰⁰ as this required updates to China's domestic legal framework.

6.5.1 Regulatory Convergence: China's Domestic Reforms and European Union Equivalence

In international financial markets, in response to the requirements of the G20 2009 Pittsburgh Summit, major economies such as the United States and the European Union have already implemented legislative and regulatory upgrades mandating CCP clearing for key OTC derivatives, including CDS and interest rate swaps (hereinafter IRS).⁶⁰¹ This regulatory trend presents Chinese financial institutions with both challenges and opportunities:

First is the need to reduce capital pressure and lower margin requirements. Under the latest global rules on OTC derivatives regulation, Chinese financial institutions that fail to clear through a CCP face significantly higher capital charges. As their OTC derivatives transactions with overseas counterparties become increasingly frequent, participation in CCP clearing has become an inevitable choice to lower transaction costs and ease capital burdens. Second, beyond external regulatory pressures, Chinese financial institutions themselves have an urgent need for more efficient clearing and risk management. With the deepening of interest rate and exchange rate market reforms in China, as well as the increase in cross-border projects and capital flows under the Belt and Road Initiative, the demand of Chinese firms and financial institutions to manage foreign currency asset risks continues to grow. CCP clearing not only satisfies external compliance requirements, but also provides advanced risk management tools, helping Chinese institutions to better manage risks in the process of globalisation.⁶⁰²

⁶⁰⁰ European Commission, Commission Implementing Decision (EU) 2022/9984 of 22 June 2022 on the Equivalence of the Regulatory Framework of the People's Republic of China for Central Counterparties That Are Authorised to Clear OTC Derivatives in the Interbank Market and Supervised by the People's Bank of China to the Requirements of Regulation (EU) No. 648/2012 of the European Parliament and of the Council [2022] OJ L167/103.

⁶⁰¹ Under the framework of the Dodd–Frank Act, the US CFTC issued directives mandating central clearing for key products such as interest rate swaps (hereinafter IRS) and credit default swaps (hereinafter CDS). Similarly, EU EMIR empowers the ESMA to assess and mandate the clearing of specific categories of derivatives, including IRS and CDS.

⁶⁰² Basong Ba, 'Cross-Border OTC Derivatives Clearing: New International Regulatory Standards and China's Institutional Choices' Yicai (14 March 2018) <<https://www.yicai.com/news/5406617.html>>

In international financial markets, netting is at the core of the functioning of central clearing mechanisms. Its basic principle is that, in the event of a counterparty's default or bankruptcy, all outstanding claims and obligations can be offset against one another, with only the final net balance being settled (see explanation in Chapter 3, CCP sector). In China, however, this mechanism has long faced legal challenges. The main difficulty lies in the provisions on mortgage rights under the property law and related legislation.

According to China's property law⁶⁰³, creditors enjoy priority rights over collateral, with their claims being satisfied before those of other unsecured creditors, except where otherwise provided by law.⁶⁰⁴ In derivatives transactions, the margin collected by a clearing house may be regarded as collateral provided by the counterparty. When a clearing member goes bankrupt, its creditors (such as banks) could invoke the property rights law to claim priority over the margin, thereby challenging the legality of netting by the clearing house. This legal conflict has created uncertainty over the enforceability of netting in China and constitutes a potential source of systemic risk. For this reason, major international CCPs, concerned about the associated legal risks, have consistently cited this issue as grounds for refusing to accept Chinese legal entities as direct clearing members.

It was not until the promulgation of the Futures and Derivatives Law in 2022 that a crucial legal breakthrough was achieved in resolving this dilemma. The law explicitly provides that in futures and derivatives transactions, the legal effect of netting takes precedence over other legal provisions.⁶⁰⁵ This clause effectively resolves, at the statutory level, the conflict between netting and the rules on mortgage rights under the property law, thereby providing solid legal protection for clearing houses to enforce netting in the event of bankruptcy.

This legal advancement was quickly recognised by the international community. In the same year, the European Commission granted equivalence status to the Shanghai Clearing House⁶⁰⁶, which operates under the supervision of the PBoC. This meant that EU

⁶⁰³ National People's Congress, Property Law of the People's Republic of China (adopted 16 March 2007, promulgated by Order No. 62 of the President of the PRC, effective 1 October 2007).

⁶⁰⁴ Ibid, art 170.

⁶⁰⁵ Futures and Derivatives Law of the People's Republic of China (adopted 20 April 2022, effective 1 August 2022) Order No. 111 of the President of the PRC, Arts 25 and 37.

⁶⁰⁶ European Commission, Commission Implementing Decision (EU) 2022/984 of 22 June 2022 on the equivalence of the regulatory framework of the People's Republic of China for central counterparties authorised to clear OTC derivatives in the interbank market and supervised by the People's Bank of China to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council [2022] OJ L167/103.

regulators and financial institutions acknowledged the regulatory framework and risk management system of the Shanghai Clearing House as being on par with EU standards. The decision marked a milestone in China's integration into global financial infrastructure, not only paving the way for closer connectivity between Chinese and European financial markets, but also providing the legal and institutional foundation for Chinese financial institutions to participate more broadly in the international clearing system in the future.

6.5.2 Hong Kong as a Transitional Conduit Prior to Direct Recognition

Before the Shanghai Clearing House obtained an equivalence decision, mainland Chinese banks engaging in OTC derivatives transactions with overseas institutions were required to clear through a recognised CCP. Since the status of netting under Chinese law had not been clearly established, mainland banks were often unable to become direct clearing members of foreign CCPs. As a result, clearing was typically conducted through clearing brokers that were members of those foreign CCPs, acting as agents on behalf of mainland banks. In the Asian time zone, Hong Kong Exchanges and Clearing's OTC Clearing Company serves as an internationally recognised clearing house for OTC derivatives, providing Asian financial institutions with more capital-efficient treatment when managing CCP exposures.

Therefore, prior to the Shanghai Clearing House obtaining EU equivalence status, Hong Kong played a crucial role in the field of central clearing, serving as the key bridge between Chinese financial institutions and international markets.

At that time, when mainland Chinese banks engaged in OTC derivatives transactions with overseas institutions, the lack of legal clarity on netting under China's legal framework meant that they were generally unable to become direct clearing members of foreign CCPs. This legal uncertainty forced mainland banks to rely on clearing brokers that were members of foreign CCPs to complete clearing on their behalf. Such an arrangement not only added extra steps and costs to transactions, but also limited the ability of Chinese banks to manage risks directly. It was against this backdrop that Hong Kong's unique role came to the fore. As an OTC clearing house recognised by international regulatory authorities, OTC Clearing Hong Kong Limited (hereinafter OTC Clear) became an important option in the Asian time zone. It not only provided mainland Chinese financial institutions with a channel to meet international clearing requirements, but also allowed

them to benefit from more capital-efficient treatment when managing CCP exposures.⁶⁰⁷ This shows that before a fully established legal and regulatory framework was in place, Hong Kong, as China's financial and economic city, was able to leverage its unique legal and financial advantages to effectively connect mainland China with international markets, providing both sides with a de facto channel of connectivity.

Unlike the trading obligation for shares, where equivalence with China was never a realistic possibility given the absence of foreign listings in the mainland market and the tight control of cross-border equity flows, the recognition of CCPs presents a fundamentally different picture. CCPs are core financial market infrastructures whose systemic importance and global connectivity make them indispensable to the functioning of international finance.

Before China updated its domestic legal framework to align more closely with international and EU standards, access to the mainland market was effectively mediated through Hong Kong, which had long served as the European Union's recognised conduit in other financial areas. Yet in the case of clearing, Hong Kong could only act as a temporary channel. Given the centrality of CCPs, the European Union was unwilling to rely permanently on an intermediary and instead pursued direct engagement with mainland China, leading to the eventual equivalence recognition under EMIR. This equivalence decision also created strong incentives for China to update its domestic legal regime, aligning more closely with international standards. Such alignment, however, has been pursued within the distinctive Chinese approach of 'controlled openness within a closed system', reflecting both the willingness to connect with global norms and the persistence of tight state management over capital markets.

6.6 Conclusion

This chapter has examined the interaction between the European Union's equivalence regime and the particularities of China's capital market, highlighting the brokerage role of Hong Kong as both an offshore centre and a mid-shore financial node. The analysis shows that China's institutional model of 'limited openness and closed operation', grounded in a state-capitalist logic, renders the application of EU equivalence standards highly

⁶⁰⁷ Basong Ba, 'Cross-border OTC Derivatives Clearing: New International Regulatory Standards and China's Institutional Choices' Yicai (14 March 2018) <<https://www.yicai.com/news/5406617.html>>

constrained. In the equity domain, the mainland market remains closed to foreign participation, leaving no practical basis for an EU equivalence decision. Yet as the world's second-largest economy, China cannot be overlooked. Since Hong Kong operates closely integrated channels with the mainland through mechanisms such as Stock Connect, granting equivalence to Hong Kong provides the European Union with indirect access to Chinese capital flows. By contrast, in the field of central clearing, an area of core financial infrastructure linked to systemic stability rather than cross-border capital inflows, equivalence has been established directly, consistent with both the European Union's functional priorities and China's own proactive efforts to align its domestic framework with international standards.

Hong Kong's function as a conduit illustrates how global financial networks operate through brokerage cities, enabling connectivity where political or institutional frictions would otherwise hinder cooperation. At the same time, the European Union's pragmatic reliance on instruments such as China's 'no-objection letters' underscores the importance of technocratic trust and administrative flexibility in bridging legislative gaps. Together, these dynamics demonstrate that the European Union's equivalence regime does not operate in a vacuum of formal legal alignment, but is embedded in a wider transnational context where politics, institutional legacies, and networked intermediaries play decisive roles.

Ultimately, the European Union–China case highlights that equivalence is less about exporting a single regulatory template and more about negotiating workable interfaces across divergent systems. The differentiated pathways observed – via Hong Kong's intermediary role and via targeted legal reforms in mainland China – suggest that the future of equivalence in relation to China will remain contingent, adaptive, and closely tied to the balance between financial openness and political control.

CONCLUSION

Previous scholarship largely focused on specific segments of financial services, the network of international regulation formed by soft laws issued by global institutions or transatlantic regulatory coordination. However, it has often overlooked a comprehensive examination of how a coherent set of domestic financial rules within a leading jurisdiction interacts with the broader process of global rule-making. This thesis has examined the European Union's equivalence regime as both a legal instrument and a governance technique, situating it within the broader dynamics of European Union financial integration and global regulatory cooperation. This thesis has argued that the EU equivalence regime should be understood not as a merely technical market access mechanism, but as a distinctive form of post-crisis financial governance. Its significance lies in the fact that it emerged at the intersection of several larger transformations in international finance: the limits of pre-crisis soft-law coordination, the post-crisis rise of financial stability as an organising objective, the expansion of more assertive forms of territorial and extraterritorial regulatory control, and the growing need to manage the fragmentation produced by overlapping claims of jurisdiction. The thesis argues that equivalence is a structured mechanism of conditional reliance through which the European Union seeks to reconcile openness to cross-border finance with the preservation of prudential control.

The thesis began by situating equivalence within the broader evolution of international financial governance. Before the global financial crisis, cross-border financial regulation relied heavily on soft-law coordination, international standard-setting, and technocratic networks. These arrangements were important in producing a degree of convergence, but the crisis exposed their institutional limits. In particular, it revealed that, where systemic stress, distributive consequences, and crisis management responsibilities were involved, soft coordination alone was often too weak to sustain stable and reliable co-operation. At the same time, the post-crisis turn towards stronger host control and more assertive extraterritorial regulation did not simply solve this problem. It generated another one. The more forcefully major jurisdictions sought to secure their own financial stability through unilateral reach, the greater the risks of market fragmentation, regulatory overlap, duplicative compliance, and conflict between competing legal orders. The central claim of the thesis has therefore been that equivalence must be understood against this double

background. It emerged as a mechanism intended to mediate between the weakness of soft law and the disintegrative effects of unilateral regulatory expansion.

From that perspective, equivalence appears as an intermediate governance technique. It does not restore a world of purely voluntary co-ordination, nor does it abandon host jurisdiction control in favour of unqualified deference. Rather, it allows a jurisdiction to retain control over access to its market and the protection of its regulatory objectives while conditionally relying on the regulatory and supervisory framework of a third country. This is why the thesis has treated equivalence as a form of managed reliance. Its function is not simply to open markets, but to organise cross-border connection under conditions of legal diversity, prudential concern, and institutional asymmetry. That intermediate character is what makes it especially important in the governance of post-crisis finance.

At the same time, the thesis has shown that such a mechanism can only operate within a wider international technocratic structure. Equivalence does not function in isolation from the soft-law environment out of which it developed. On the contrary, its practical possibility depends on the existence of shared standards, repeated interaction among regulators, and a degree of mutual intelligibility regarding supervisory objectives and regulatory outcomes. For this reason, the thesis incorporated limited insights from constructivism and epistemic community scholarship. These were not introduced as a free-standing theoretical ambition, but to explain the conditions under which equivalence can work in practice. International technocratic networks help generate the background understandings, regulatory languages, and forms of professional trust that make comparability and conditional reliance possible. In that sense, equivalence does not replace soft-law governance. It builds upon it, while also moving beyond it by attaching more structured institutional and market consequences to co-operation and comparability.

Within the EU legal order, the thesis has argued that equivalence is shaped above all by financial stability and by the institutional logic of regulatory centralisation. Financial stability is not merely one policy goal among others. It is deeply embedded in the architecture of the regime. It helps explain why equivalence appears in some sectors and not in others, why it is more open in some contexts and more restrictive in others, and why the depth of monitoring, supervisory engagement, and conditionality varies across different legislative settings. The regime is therefore neither uniform nor neutral. Its structure

reflects differentiated assessments of risk, dependence, and prudential sensitivity. At the same time, equivalence has also contributed to the internal centralisation of authority within the European Union. It has shifted important elements of third-country assessment, market-entry management, and supervisory co-ordination away from fragmented national control and towards the EU level. The discussion of ESMA was central to this point. By analysing its role through both its specific functions and its broader internal and external dimensions, the thesis showed that technocratic authority within equivalence operates both as an instrument of Union-wide regulatory consolidation and as a point of engagement with third-country and international actors.

The sectoral chapters further demonstrated that equivalence cannot be understood through a single abstract formula. Its meaning and function vary according to the nature of the regulatory object involved. In the field of EMIR and MiFIR, the thesis examined the most developed and operationally significant equivalence regimes in the post-crisis EU framework, including third-country CCP recognition, the dual-track access approaches for third-country investment firms, and the rather limited trading-venue dimension. In these areas, equivalence forms part of a relatively elaborate framework for managing third-country access to EU financial markets. By contrast, the other sectoral chapter examined equivalence regimes including Credit Rating Agencies, insurance, funds, and issuer disclosure, present a more fragmented picture. Although equivalence remains available in these fields, it operates in more specific and uneven forms, shaped by the particular regulatory concerns of each sector. The thesis has therefore shown that equivalence is differentiated not simply by the existence or non-existence of decisions, but by the regulatory setting in which it operates and the function it is made to perform.

This differentiated character becomes still clearer when one moves from the internal design of the regime to its external application. The thesis has argued that the Union's external equivalence practice is shaped by two underlying policy drivers: financial stability and regulatory power projection. The first concerns the management of dependence, systemic risk, and prudential exposure. The second concerns the preservation of regulatory autonomy, the management of competition with other financial centres, and the extension of the Union's regulatory influence beyond its own territory. A central contribution of the thesis has been to show that these drivers do not operate separately, but in mixed configurations. Their relative weight varies across different jurisdictional relationships. For

that reason, the thesis developed a model-based account of EU external governance through equivalence, identifying three recurrent patterns: an integrationist model, a defensive model, and a negotiationist model. These models do not claim to exhaust all possibilities, nor do they operate as rigid classificatory boxes. Their value lies in clarifying that the same legal mechanism can be deployed in different ways depending on the strategic, institutional, and market conditions of the relationship concerned.

It is precisely here that Chapter 6 acquires its significance within the thesis as a whole. It extends and deepens the analytical framework developed in the preceding chapters by showing that the differentiated operation of equivalence can also be spatial and jurisdictional when reaching out to a relatively closed market. The EU-China-Hong Kong analysis demonstrates that, when the Union confronts a relatively closed capital market, external regulatory connection does not necessarily proceed through a single direct route. Instead, it may take different forms depending on the systemic importance of the financial activity concerned and the degree of openness or inaccessibility of the target market. In tightly coupled areas, especially where critical financial infrastructures are concerned, the Union may seek more direct forms of regulatory connection. In more market-oriented sectors, by contrast, connection may be mediated through an intermediary jurisdiction.

This is why the analysis of Hong Kong is important. Its place in the thesis is not simply to illustrate the special features of China's market structure, still less to reproduce the familiar view of Hong Kong as merely an instrument of mainland China. The point is rather to examine Hong Kong from the perspective of EU external governance. From that perspective, Hong Kong appears as a brokerage city through which the Union may pursue differentiated forms of regulatory connection and influence. It functions as a jurisdictional intermediary that can facilitate looser forms of coupling where direct regulatory integration with mainland China is difficult, uneven, or strategically unnecessary. Chapter 6 therefore shows that the Union's external regulatory projection is not only selective in legal and institutional terms, but also geographically mediated. The external operation of equivalence must accordingly be understood not just as a matter of sector-specific legal technique or bilateral policy choice, but as part of a broader spatial strategy of differentiated connection.

The full arc of this thesis therefore can be understood in three stages. It began by explaining why equivalence emerged within the changing international order of post-crisis financial regulation. It then analysed how the regime is constituted and differentiated within the EU legal order. It finally showed how the regime operates externally, both through general models of application and through more specific forms of mediated connection in relation to relatively. Seen as a whole, the thesis therefore reaches a number of connected conclusions. First, equivalence is embedded in international technocratic governance rather than standing apart from it. It depends on the shared standards, professional understandings, and institutionalised interaction generated by the soft-law networks of international financial regulation. Secondly, equivalence is not neutral in its internal EU form. It is shaped by financial stability and contributes to the centralisation of regulatory authority at the EU level, particularly through institutions such as ESMA. Thirdly, the regime is internally differentiated. Although it has a recognisable overall structure, it appears in different forms across different sectors of the financial acquis depending on the function of the market activity being regulated. Fourthly, the regime is also externally differentiated. Its outward operation is driven by varying combinations of prudential concern and regulatory power projection, and these combinations produce different patterns of governance. Finally, that differentiation also includes spatially mediated forms of connection, as the China and Hong Kong analysis demonstrates.

The broader implication is that equivalence should be taken seriously as an important institutional form of post-crisis governance. It cannot be a complete solution to the tensions of cross-border finance, nor does it eliminate the underlying conflicts between openness, autonomy, competition, and prudential control. It is a pragmatic response to a world in which full harmonisation is unrealistic, pure soft-law coordination is often too weak, and unchecked unilateralism is too fragmenting. Its significance lies in its capacity to organise conditional market connection without demanding legal identity, and to structure external reliance without surrendering regulatory authority. In that sense, equivalence reflects a wider reorganisation of international financial governance away from simple binaries of co-operation versus unilateralism, and towards more complex forms of conditional, differentiated, and strategically managed interdependence.

ANNEXURE A: OVERVIEW OF EQUIVALENCE REGIMES

Table A.1: European Union legislation where there is no provision for equivalence

Bank Recovery and Resolution Directive (BRRD)	Mortgage Credit Directive (MCD)
Cross-border Payments Regulation (CBPR)	Motor Insurance Directive (MID)
Deposit Guarantee Schemes Directive (DGSD)	Packaged Retail and Insurance-based Investment Products (PRIIPs)
European Long-term Investment Fund Regulation (ELTIF)	Pan-European Personal Pension Product (PEPP)
European Social Entrepreneurship Funds Regulation (EuSEF)	Payment Accounts Directive (PAD)
European Venture Capital Funds Regulation (EuVECA)	Payment Services Directive (PSD)/Second Electronic Money Directive (2EMD)
Financial Collateral Directive (FCD)	Settlement Finality Directive (SFD)
Institutions for Occupational Retirement Provision II Directive (IORP II)	Single Euro Payments Area Regulation (SEPA)
Insurance Distribution Directive (IDD) (formerly IMD)	Single Resolution/Supervisory Mechanism Regulation (SRR/SRM))
International Accounting Standards Regulation (IAS)	Undertakings for the Collective Investment in Transferable Securities (UCITS)
Money Market Funds Regulation (MMFs)	

Table A.2: Current equivalence decisions overlooked

Type of equivalence	Equivalence decision	No. of countries
Accounting Directive	Art 47 – Country-by-country reporting	1
Alternative Investment Fund Managers Directive (AIFMD)	/	0
Benchmarks Regulation (BMR)	Art 30(3) – Specific administrators or benchmarks (2) (3)	2
Credit Rating Agencies Regulation (CRA)	Art 5(6) – Legal and supervisory framework	4
Capital Requirements Regulation (CRR)/Capital Requirements Directive (CRD)	Art 107(4) – Credit institutions (Annexure I)	26
	Art 107(4) – Investment firms (Annexure II)	13
	Art 107(4) – Exchanges (Annexure III)	13
	Art 114(7), 115(4), 116(5) – Credit institutions (Annexure IV)	26
	Art 142(2) – Credit institutions (Annexure V)	26
	Art 142(2) – Investment firms (Annexure V)	13
	Art 391 – Credit institutions (Annexure VI)	26
	Art 391 – Investment firms (Annexure VI)	13
Central Securities Depositories Regulation (CSDR)	/	0
European Market Infrastructure Regulation (EMIR)	Art 1(6) – Third country central banks and public bodies	9
	Art 2(a) – Regulated markets	5
	Art 13(2) – Transaction requirements	7
	Art 25(6) – CCPs	23
Financial Conglomerates Directive (FICOD)	/	0
Market Abuse Regulation (MAR)	Art 6(5) – Third country central banks and public bodies	14
Markets in Financial Instruments Directive (MIFID)	Art 25(4)(a) – Trading venues for the purposes of the share trading obligation (STO)	3
Market in Financial Instruments Regulation (MIFIR)	Art 1(9) – Third country central bank	14
	Art 28(4) – Trading venues for the purposes of derivatives trading obligation (DTO)	2

Prospectus Directive (PD)	/	0
Securities Financing Transaction Regulation (SFTR)	/	0
Short Selling Regulation (SSR)	/	0
Solvency II Directive	Art 172 – Third country reinsurers	2
	Art 227 – Capital requirements and own funds	7
	Art 260 – Group supervision	2
Statutory Audit Directive	Art 46(2) – Audit framework	22
	Art 47(3) – Competent authorities	17
Transparency Directive (TD)	Art 23(4) – Third country Generally Accepted Accounting Principles (GAAP) with International Financial Reporting Standards (IFRS)	5

Notes

1) Argentina, Australia, Brazil, Canada, Singapore and South Africa do not benefit from credit rating agency (CRA) equivalence but benefit from the endorsement regime.

2) Based on the documents compiled from the Commission's official website, the original file along with the specific countries granted equivalence can be seen at: https://finance.ec.europa.eu/document/download/013005aa-8040-4b1e-b518-bc76b5bb9ba7_en?filename=overview-table-equivalence-decisions_en.pdf

Table A.3: Implementation of equivalence clauses

Type of equivalence	Article	Equivalence decision	Market access?	What having equivalence (or not having it) would mean for third countries
Accounting Rules Directive				
Reporting requirements for extractive and logging industries	Art 47	1	No	European Union (EU) firms active in third country extractive and logging industries can report payments made to third country governments in their country of origin. Without equivalence EU firms must comply with third country and EU reporting requirements.
Alternative Investment Fund Managers Directive (AIFMD)				
Management and marketing of funds to professional clients	Arts 32 and 33	0	Yes	Third country firms can market – and manage – European Equity Fund Inc. (EEA)/non-EEA private equity funds, hedge funds, funds of funds and real estate funds to EU institutional investors from the third country. Without equivalence, third country firms must set up a subsidiary in the European Union and possibly set up <u>authorised</u> branches to access national markets.
Benchmarks Regulation (BMR)				
Use of financial benchmarks	Art 30(3)	2	Yes	Third country-based firms must be registered with the European Securities and Markets Authority (ESMA) and apply International <u>Organisation of Securities Commissions (IOSCO)</u> benchmark principles for their benchmarks to be used by EU customers. Without equivalence, third country firms must set up an EU subsidiary for EU firms and individuals to use their benchmarks.
Credit Rating Agencies Regulation (CRAR)				
Credit rating agency ratings and activities	Art 5(6)	4	Yes	Third country-based credit rating agencies whose activities do not pose a threat to the financial stability of one or more EU countries can sell products to EU clients from the third country, and EU firms will be able to use their ratings. Without equivalence, third country firms must set up a subsidiary in the European Union for their ratings to be used by EU clients.
Capital Requirements Regulation (CRR) / Capital Requirements Directive (CRD)				
Credit institutions (treatment of exposures)	Art 107(4)	26	No	European Union (EU) banks' exposures to third country firms will be treated more <u>favourably</u> and may have the same risk weights as exposures to EU firms. Without equivalence, EU banks' exposures to third country firms may be considered riskier

Type of equivalence	Article	Equivalence decision	Market access?	What having equivalence (or not having it) would mean for third countries and more costly.
Credit institutions (treatment of exposures to central banks and governments, regional government and local authorities, public bodies)	Arts 114(7), 115(4), 116(5)	26	No	European Union (EU) banks' exposures to the third country central banks and governments, regional government and local authorities, and public bodies will be treated more <u>favourably</u> and may have the same risk weights as exposures to EU central banks and governments.
Credit institutions (large financial sector entity, use of internal ratings-based approach)	Art 142(2)	26	No	Third country banks considered to be 'large financial sector entities' can use the internal ratings-based approach to credit risk. Without equivalence, this will not be possible
Credit institutions (<u>institution for large exposures</u>)	Art 391	26	No	Third country credit institutions considered to be 'large exposures institution' can use the internal ratings-based approach to credit risk. Without equivalence, this will not be possible.
Treatment of exposures to exchanges	Art 107(4)	13	No	EU firms' exposures to third country exchanges will be treated the same as exposures to European Union exchanges. Without equivalence, these exposures may be seen as <u>riskier</u> and more costly.
Investment firms (large financial sector entity, use of internal ratings-based approach)	Art 142(2)	13	No	Third country investment firms considered to be 'large financial sector entities' can use the internal ratings-based approach to credit risk. Without equivalence, this will not be possible.
Treatment of exposures to investment firms	Art 107(4)	13	No	European Union (EU) firms' exposures to third country investment firms will be treated the same as exposures to EU investment firms. Without equivalence, EU firms' exposures to third country firms may be seen as <u>riskier</u> and more costly
Investment firms (<u>institution for large exposures</u>)	Art 391	13	No	Third country investment firms considered to be 'large exposures institution' can use the internal ratings-based approach to credit risk. Without equivalence, this will not be possible.

Type of equivalence	Article	Equivalence decision	Market access?	What having equivalence (or not having it) would mean for third countries
Central Securities Depositories Regulation (CSDR)				
Central securities depositories (CSDs) (provision of services)	Art 25 (1)	0	Yes	Third country central securities depositories (CSDs) can serve European Union (EU) clients from the third country. Without equivalence, third country CSDs must set up an EU subsidiary to provide services to EU clients, and possibly set up branches to access national markets.
European Market Infrastructure Regulation (EMIR)				
Central counterparties (CCPs) (provision of services)	Art 25(6)	23	Yes	Third country central counterparties (CCPs) can provide clearing services to European Union (EU) clearing members and trading venues from the third country. Without equivalence, third country CCPs must set up an EU subsidiary to provide clearing services in the EU.
Regulated markets (treatment of derivatives traded in third countries)	Art 2(a)	5	No	Derivatives trading on third country trading venues will not be considered as over the counter (OTC), meaning lower risk weights and costs for counterparties. Without equivalence, all derivatives trades in the third country will be OTC and counterparties face higher risk weights and costs.
Transaction requirements (counterparties)	Art 13(2)	7	No	European Market Infrastructure Regulation (EMIR) transactions between third country firms and European Union (EU) firms can avoid duplicative or conflicting requirements. Without equivalence, third country and EU firms must comply with requirements and rules in both markets.
Trade repositories (provision of services)	Art 75(1)	0	Yes	Third country trade repositories can provide services to European Union (EU) firms from the third country. Without equivalence, third country trade repositories must set up an EU subsidiary
Exemptions for central banks	Art 1(6)	9	No	Third country central banks will be exempt from certain European Market Infrastructure Regulation (EMIR) requirements on derivatives contracts with a European Union (EU) entity. Without equivalence, it must comply with EMIR derivatives requirements.

Type of equivalence	Article	Equivalence decision	Market access?	What having equivalence (or not having it) would mean for third countries
Financial Conglomerates Directive (FICOD)				
Supervision of conglomerates	Art 18(1)	0	No	European Market Infrastructure Regulation- (EEA) regulated entities of third country financial groups will be supervised by third country supervisory authorities. Without equivalence, third country firms' EEA businesses must be supervised by both third country and European Union authorities.
Market Abuse Regulation (MAR)				
Exemptions for central banks and public bodies	Art 6(5)	0	No	The third country central banks and public bodies will be exempt from certain Market Abuse Regulation (MAR) disclosure requirements and rules. Without equivalence, they must comply with all MAR requirements.
Markets in Financial Instruments Directive (MIFID) / Market in Financial Instruments Regulation (MIFIR)				
Trading venues for the purpose of trading obligation for derivatives	Art 28(4) <u>MiFIR</u>	2	Yes	European Union (EU) firms can use third country trading venues to trade derivatives. Without equivalence, EU firms will not be able to trade derivatives in third country venues.
Derivatives trade execution and clearing obligation requirements for <u>counterparties</u>	Art, 30(1) <u>MiFIR</u>	0	No	Derivatives trading between third country and European Union (EU) firms on third country trading venues will meet EU trade execution and clearing requirements. Without equivalence, this won't be the case.
Trading venue and central <u>counterparty</u> (CCP) access to benchmarks and <u>licences</u> for the purpose of clearing and trading obligations	Art 38(3) <u>MiFIR</u>	0	Yes	Third country trading venues and central <u>counterparties</u> (CCPs) may access European Union (EU) trading venues and <u>CCPs</u> , and use EU benchmarks and <u>licences</u> . Without equivalence, third country trading venues and <u>CCPs</u> must set up an EU subsidiary to access EU trading and clearing venues, benchmarks and <u>licences</u> .
Investment firms (provision of services to professional clients)	Art 46(1) <u>MiFIR</u>	0	Yes	Third country investment firms can provide services to European Union (EU) institutional clients and <u>counterparties</u> from the third country. Without equivalence, third country investment firms must set up an EU subsidiary (and possibly an <u>authorised</u> branch to access a national market) to service institutional clients in the European Union.

Type of equivalence	Article	Equivalence decision	Market access?	What having equivalence (or not having it) would mean for third countries
Trading venues for the purpose of trading obligation for shares (stock exchange equivalence)	Art 25(4) <u>MiFID II</u>	3	Yes	Shares listed and traded in the European Union (EU) can be traded in third country trading venues. Without equivalence, EU-listed shares cannot be traded in third country venues.
Exemptions for central banks	Art 1(9) <u>MiFIR</u>	14	No	Third country central banks may be exempt from certain requirements if their transactions are for regulatory purposes. Without equivalence, they must comply with all Markets in Financial Instruments Regulation (<u>MiFiR</u>) requirements.
Prospectus Directive (PD)				
Use of prospectus	Art 4(1)	0	No	Prospectuses of third country firms can be used in public offerings of securities in the European Union (EU). Without equivalence, all third country public offering prospectuses must be approved by the EU.
Securities Financing Transaction Regulation (SFTR)				
Exemptions for central banks and public bodies	Art 15	0	No	The third country central banks may be exempt from certain requirements on transparency of securities financing transactions. Without equivalence, they must comply with all these requirements.
Trade repositories (provision of services)	Art 19	0	Yes	Third country trade repositories can provide services to European Union (EU) firms from the third country. Without equivalence, third country trade repositories must set up an EU subsidiary to provide services to EU clients.
Disclosure requirements for <u>counterparties</u>	Art 21	0	No	Transactions between third country and European Union (EU) firms can avoid <u>duplicative</u> or <u>conflicting</u> disclosure requirements. Without equivalence, third country and EU firms must comply with requirements in both markets.
Short Selling Regulation (SSR)				
Market-making activities	Art 17	0	No	Third country firms need not notify European Union (EU) authorities of significant net short positions in shares and sovereign debt for purposes of market-making if third country authorities have been notified or those positions are publicly disclosed. They are also exempt from EU restrictions on uncovered short sales. Without equivalence, third country firms must comply with EU and third country disclosure requirements on short positions, and with EU restrictions on uncovered short sales

Type of equivalence	Article	Equivalence decision	Market access?	What having equivalence (or not having it) would mean for third countries
Solvency II Directive				
Equivalent treatment of <u>reinsurers'</u> activities	Art 172	2	Yes	Third country <u>reinsurers</u> can enter into a contract with a European Union (EU) insurance firm from the third country. Without equivalence, third country <u>reinsurers</u> must set up a subsidiary in the European Union.
Solvency rules for calculation of capital requirements and own funds of insurers	Art 227	7	No	European Equity Fund Inc. (EEA) insurance and reinsurance groups with third country entities may use third country rules to calculate the capital (own funds) and solvency capital requirement for that entity. Without equivalence, third country arms of EEA firms must comply with third country rules and European Union Solvency II requirements.
Equivalence of group supervision by third country supervisory authorities	Art 260	2	No	European Equity Fund Inc. (EEA) branches or subsidiaries of third country-based insurers and <u>reinsurers</u> can be supervised by third country authorities. Without equivalence, EEA subsidiaries of third country-based insurers and <u>reinsurers</u> must be supervised by third country and European Union authorities.
Statutory Audit Directive				
Equivalence of audit framework (exemptions in registration and oversight for auditors and audit firms)	Art 46(2)	22	No	Third country auditors and audit firms providing audit reports or financial statements for third country firms whose securities are traded in a European Union- (EU) regulated market do not need to register in the European Union or be overseen by EU authorities. Without equivalence, third country audit firms must comply with EU and third country rules on registration and oversight.
Adequacy of competent authorities	Art 47(3)	17	No	European Union (EU) authorities can share with third country authorities audit working documents relating to EU companies that have issued securities in the third country or groups that issue consolidated financial statements in the third country. Without equivalence, third country authorities cannot receive these confidential audit documents on EU companies with third country-listed securities or that report consolidated financial statements in the third country.

Type of equivalence	Article	Equivalence decision	Market access?	What having equivalence (or not having it) would mean for third countries
Transparency Directive (TD)				
General transparency and disclosure standards requirements	Art 23(2)	0	No	Third country firms subject to EU transparency rules can comply with third country transparency and disclosure standards when reporting financial and shareholder information. Without equivalence, third country firms must meet third country and EU transparency and disclosure standards.
Consolidated financial statements (third country Generally Accepted Accounting Principles (GAAP) with International Financial Reporting Standards (IFRS))	Art 23(4)	5	No	Third country firms subject to EU rules on transparency and prospectuses can present their consolidated financial statements according to third country requirements on financial statements and accounting standards. Without equivalence, third country firms must meet EU and third country financial statements and accounting standards.

Source: Asimakopoulos and Wright,⁶⁰⁸ with the researcher's addition of legal provisions and updated equivalent decisions based on the latest practices of the committee.

⁶⁰⁸ Panagiotis Asimakopoulos and William Wright, 'A Reality Check on Equivalence: Analysis of the EU Equivalence Regime, How It Works, And What It Means For UK Financial Services in the Context of Brexit, New Financial LLP working paper, February 2020.

ANNEXURE B: ABBREVIATIONS AND GLOSSARY

Abbreviations

€STR	euro short-term rate
2EMD	Second Electronic Money Directive
AAR	Active Account Requirement
AD	Accounting Directive
AIF	alternative investment fund
AIFMD	Alternative Investment Fund Managers Directive
ARC	Accounting Regulatory Committee
BCN	broker crossing network
BIT	bilateral investment treaty
BMR	Benchmarks Regulation
BRRD	Bank Recovery and Resolution Directive
BTS	Binding Technical Standards
CBIRC	China Banking and Insurance Regulatory Commission
CBPR	Cross-border Payments Regulation
CCP	central <u>counterparty</u>
CCRAR	Consolidated Credit Rating Agency Regulation
CCS	cross-currency swap
CDR	Capital Requirements Directive and Regulation
CDS	credit default swap
CEA	Commodity Exchange Act
CEBS	Committee of European Banking Supervisors
CEDR	China–Europe <u>Depository Receipt</u>
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of European Securities Regulators
CFTC	Commodity Futures Trading Commission
CIS	collective investment schemes
CJEU	Court of Justice of the European Union
CMU	Capital Markets Union
CNA	competent national authority
CNMV	National Securities Market Commission
CPMI	Committee on Payments and Market Infrastructures
CRA	credit rating agency
CRAR	Credit Rating Agencies Regulation
CRD	Capital Requirements Directive
CRM	credit risk management
CRMA	Credit Risk Mitigation Analysis
CRMW	Credit Risk Mitigation Warrant
CRR	Capital Requirements Regulation
CSDC	China Securities Depository and Clearing Corporation
CSDR	Central Securities Depositories Regulation

CSRC	China Securities Regulatory Commission
DCM	Designated Contract Market
DCO	derivatives clearing <u>organisation</u>
DGSD	Deposit Guarantee Schemes Directive
DORA	Digital Operational Resilience Act
DTO	Derivatives Trading Obligation
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Equity Fund Inc.
EEA	European Economic Area
EEAP	European Electronic Access Point
EFTA	European Free Trade Association
EIOPA	European Insurance and Occupational Pensions Authority
ELTIF	European Long-term Investment Fund Regulation
EMIR	European Market Infrastructure Regulation
EMU	Economic and Monetary Union
ESA	European Supervisory Authority
ESEF	European Single Electronic Format
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETD	exchange-traded derivative
EU	European Union
EU 27	27 countries of the European Union
EUR	euro
<u>EuSEF</u>	European Social Entrepreneurship Funds Regulation
<u>EuVECA</u>	European Venture Capital Funds Regulation
FABS	finance and advanced business services
FATF	Financial Action Task Force
FCD	Financial Collateral Directive
FDI	foreign direct investment
FICOD	Financial Conglomerates Directive
FINMA	Swiss Financial Market Authority
FMI	financial market infrastructures
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSF	Financial Stability Forum
FSI	Financial Stability Institute

G20	Group of Twenty
G7	Group of Seven
GAAP	Generally Accepted Accounting Principles
GATS	General Agreement on Trade in Services
GBP	British pound sterling
GDR	global <u>depository</u> receipt
GFN	global financial network
HKEX	Hong Kong Stock Exchange
IAIS	International Association of Insurance Supervisors
IARASC	Inter-American Regional Association of Securities Commissions
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASR	International Accounting Standards Regulation
ICE	Intercontinental Exchange
IDD	Insurance Distribution Directive
IFD	Investment Firms Directive
IFR	Investment Firms Regulation
IFRS	International Financial Reporting Standards
ILC	International Law Commission
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPO	initial public offering
IPSF	International Platform on Sustainable Finance
IRA	independent regulatory agency
IRD	interest rate derivatives
IRN	international regulatory network
IRS	interest rate swap
ISDA	International Swaps and Derivatives Association
ISIN	International Securities Identification Number
ISSB	international standard-setting body
ITS	Implementing Technical Standard
<u>J-IFRS</u>	Japanese International Financial Reporting Standards
KWD	<u>keepwell</u> deed
LCH	London Clearing House
LGFV	local government financing vehicle
LIBOR	London Inter-Bank Offered Rate
MAR	Market Abuse Regulation
MAS	Monetary Authority of Singapore
MBS	mortgage-backed securities
MCD	Mortgage Credit Directive

MCR	minimum capital requirement
<u>MiCAR</u>	Markets in <u>Crypto-Assets</u> Regulation
MID	Motor Insurance Directive
<u>MiFID</u>	Markets in Financial Instruments Directive
<u>MiFIR</u>	Markets in Financial Instruments Regulation
MMF	Money Market Funds Regulation
<u>MoU</u>	Memorandum of Understanding
MPOR	margin period of risk
MSR	Member State of Reference
MTF	Multilateral Trading Facility
NAFMII	National Association of Financial Market Institutional Investors
NCA	national competent authority
NFC	non-financial <u>counterparty</u>
NPPR	national private placement regime
ODRF	Over-the-Counter Derivatives Regulators' Forum
ODRG	Over-the-Counter Derivatives Regulators' Group
OECD	<u>Organisation</u> for Economic Co-operation and Development
OIS	overnight index swap
OTC	over the counter
OTF	<u>Organised</u> Trading Facility
PAD	Payment Accounts Directive (PAD)
<u>PBoC</u>	People's Bank of China
PD	Prospectus Directive
PEPP	Pan-European Personal Pension Product (PEPP)
PFMI	Principles for Financial Market Infrastructures
PLN	Polish zloty
PRIIPS	Packaged Retail and Insurance-based Investment Products
PSD	Payment Services Directive (PSD)
Q&A	question and answer
QDII	Qualified Domestic Institutional Investor QDII
QFII	Qualified Foreign Institutional Investor
RCAP	Regulatory Consistency Assessment Programme
RM	regulated market
RMB	renminbi
ROSC	Report on the Observance of Standards and Codes
RQFII	Renminbi Qualified Foreign Institutional Investor (hereinafter RQFII regime)
RTS	Regulatory Technical Standards
SAD	Statutory Audit Directive
SAR	Special Administrative Region
SASAC	State-owned Assets Supervision and Administration Commission

SCR	solvency capital requirement
SD	swap dealer
SEC	Securities and Exchange Commission
SEF	Swap Execution Facility
SEPA	Single Euro Payments Area regulation
SFD	Settlement Finality Directive
SFTR	Securities Financing Transactions Regulation
SME	small and medium-sized enterprise
SOE	state-owned enterprises
SOFR	Secured Overnight Financing Rate
SPV	special purpose vehicle
SRM	Supervisory Regulation Mechanism
SRR	Single Resolution
SSE	Shanghai Stock Exchange
SSR	Short Selling Regulation
SST	Swiss Solvency Test
STO	Share Trading Obligation
SZSE	<u>Shenzhen Stock Exchange</u>
SZSE	<u>Shenzhen Stock Exchange</u>
TC CRA	third country credit rating agencies
TD	Transparency Directive
TFEU	Treaty on the Functioning of the European Union
UCITS	Undertakings for Collective Investment in Transferable Securities
US	United States of America
USD	United States dollar
US GAAP	United States Generally Accepted Accounting Principles
UCIT	Undertakings for the Collective Investment in Transferable
VIE	variable interest entity
WTO	World Trade Organization

Glossary

Basel Committee	Basel Committee on Banking Supervision
Draft IFA	Draft Swiss/European Union Institutional Framework Agreement
IOSCO Principles	International Organization of Securities Commissions Objectives and Principles of Securities Regulation
OTC Clear	OTC Clearing Hong Kong Limited
Joint Committee	Joint Committee of the European Supervisory Authorities
repo	repurchase

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