ISDA Safe, Efficient Markets

11 March 2021

HM Treasury Call for Evidence on the UK Overseas Framework

The International Swaps and Derivatives Association, Inc. (**ISDA**)[1] welcomes the opportunity to respond to HM Treasury's Call for Evidence on the UK Overseas Framework. We have set out below ISDA's responses to questions 2 – 8 and 9(e). These comments represent the majority view of ISDA members who provided input to this response and do not address any specific firm's structure or use of the Overseas Persons Exclusion.

1. Summary

By way of a high level summary, we consider that the current regime provides certainty and proportionate regulation of cross-border business into the UK, which is critical to enable global firms to continue to have a strong UK presence as well as to enable local UK firms and corporates to access global derivatives markets.

We consider that the current regime has contributed to, and continues to contribute to, the UK's position as a global financial centre and we consider that it works well in its current form, subject to our comments below regarding some areas of complexity that would benefit from review and streamlining.

2. Responses to individual questions in the call for evidence

Question 2: Do you think that the route of access to the UK market provided for by the overseas framework adequately advances the principles set out in paragraph 1.7?

ISDA agrees that the route of access to the UK market currently provided for by the overseas framework does adequately advance the principles set out in paragraph 1.7.

There are some areas where the regime is particularly complex (which we discuss further below), which can mean that the regime is sometimes not as transparent as it could be. However, as a general rule we consider that the UK overseas regime is effective to maintain an open and globally integrated financial system, reducing barriers and frictions where appropriate

[1] **About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

while still applying robust, high quality and proportionate regulation and supporting financial stability, market integrity and consumer protection.

Key issues for ISDA members include the continued ability to access non-UK financial market infrastructure, deal with non-UK wholesale dealers and clients and enter into cross-border intragroup transactions. Subject to the comments below, we consider that the current regime provides certainty and proportionate regulation on these issues, which are critical to enable global firms to continue to have a strong UK presence as well as to enable local UK firms and corporates to access global derivatives markets.

As mentioned in the call for evidence, the UK regime has developed over a number of years and the long-standing and stable nature of the UK's overseas regime has been a key factor in enabling global firms to establish a UK presence and in enabling UK firms to export financial services and access international markets (including emerging markets and other markets which may not necessarily have rules "equivalent" to those in the UK). In our experience with cross-border regimes in other jurisdictions, restrictions on cross-border business (or uncertainty regarding the regulatory perimeter) does not only impact foreign firms seeking to access the local market, but it also impacts the ability of local entities to provide services to or otherwise deal with foreign counterparties or to access foreign exchanges and market infrastructure.

Question 3: Are there any specific risks that the current regimes for overseas firms do not adequately address?

We consider that the current regimes for overseas firms are well balanced between management of potential risks and maintaining open access. We do not consider that there are currently any specific risks that these regimes do not address.

Question 4: Are there specific complexities around the regime you think need to be addressed?

While the application of the UK overseas regime can be complicated (and can also be difficult to explain to non-UK entities and regulators, particularly with regard to the different application of UK territorial scope for different activities and the interaction of the various exemptions under the financial promotions regime with the overseas persons exclusion), it would be necessary to balance any attempts to simplify the regime with the potential impact of any changes on firms which currently rely on the regime. It may be possible to further clarify the regime through FCA guidance (e.g., in its Perimeter Guidance Sourcebook) without amending the legislative framework for the regime. The current guidance on application to cross-border business is limited and may benefit from being updated to reflect changes in cross-border business and market practice in recent years.

However, there are two key areas where it may be beneficial to simplify the regime:

- **Regulation of market infrastructure**: non-UK market infrastructure providers (including trading venues and CCPs) are currently required to navigate a range of different regimes in order to establish whether or not they can provide services to UK firms (and also whether UK firms may face problems in accessing their services). For example, a non-UK CCP seeking to allow access to UK members would need to navigate the overseas person exclusion, Article 25 of UK EMIR, the Recognised Overseas Clearing Houses regime, Part 7 of the Companies Act 1989 and UK implementation of the Settlement Finality Directive, while potential UK members would need to satisfy themselves that the non-UK CCPs meets the test for QCCP status under UK CRR. Non-UK trading venues face a similar range of regimes, with potential UK members also having to take into account the equivalence regime under Article 2a of UK EMIR, the recognised overseas investment exchange regime and also the UK share trading obligation and derivatives trading obligation. As each of these regimes has developed separately from the other regimes, they do not always use consistent definitions, have a consistent scope of application or operate as a single coherent regime.
- **Equivalence decisions:** Similar issues arise in relation to equivalence decisions inherited from EU legislation, where one piece of legislation may cross-refer to an equivalence decision in another piece of legislation without accounting for later changes in legislation or interpretation which may affect one piece of legislation but not be reflected in the other. A key example is the cross-reference to Article 13 equivalence decisions under EMIR for the purposes of determining whether intragroup exemptions under other legislation (e.g., CRR) may be available. Article 13 EMIR originally envisaged that a single equivalence decision would be given per jurisdiction, so these cross-references were drafted on that basis. However, in the event the Commission granted multiple equivalence decisions covering different regulators or regimes, partial equivalence decisions (e.g., only covering certain instrument types or counterparty types) and conditional equivalence decisions (e.g., requiring firms to take additional action in order to be able to rely on the equivalence decision). In this context, it becomes extremely difficult to work out how these cross-references apply in practice.

Aside from these comments, cross-border business may be impacted by issues other than licensing requirements, including the application of conduct of business and other obligations. For example, where the territorial scope of an obligation is particularly broad or unclear, this may also have an impact on cross-border business (e.g., in the case of the derivatives trading obligation).

Question 5: Please could you comment on the overlap between article 47 of MiFIR and the OPE. If an article 47 decision was issued, how may this affect your decisions to undertake activity in the UK?

The equivalence-based cross-border regime under Article 47 MiFIR is significantly narrower than the existing overseas person exclusion, both in the scope of activities covered and in the types of UK entities that would benefit.

In particular, it appears that Article 47 MiFIR is only available in relation to MiFID investment services and activities (with or without ancillary services). It is unclear what the position would be in relation to all the other regulated activities which currently benefit from the overseas persons exclusion in the event that an Article 47 equivalence decision was made – we understand that the grant of an Article 47 equivalence decision would mean that entities from the equivalent jurisdiction could continue to carry on other non-MiFID business within the scope of the overseas persons exclusion (and would not be restricted to doing business with UK counterparties only on the basis of that Article 47 decision) but it would be useful to clarify this. This also raises a critical question in relation to activities where it may be unclear whether or not the relevant activity constitutes a MiFID activity, requiring non-UK firms to assess which of their activities with UK clients falls within the Article 47 MiFIR regime and which might fall within the OPE or another exclusion. This adds further complexity to the UK overseas regime and may have the effect of discouraging non-UK firms from dealing with UK counterparties, particularly where there may be criminal sanctions resulting from a breach of Article 47 MiFIR.

The equivalence regime under Article 47 also provides less stability and certainty for non-UK firms than under the pre-existing UK overseas framework. As mentioned above, stability is an important factor for foreign firms in any cross-border regime, and the UK overseas framework has been fairly stable for many years now. In contrast, the Article 47 regime is new and untested (both in the EU and in the UK) and a large proportion of the public discussion around this regime has been focussed on the risk of an equivalence decision being withdrawn on short notice. On this point, we note that UK MiFIR does not appear to address the treatment of non-UK firms in the event that a non-UK jurisdiction is determined to be partially equivalent or if equivalence is withdrawn.

We would also note that in order to rely on the Article 47 equivalence regime, a non-UK firm would also need to meet the conditions in Article 46, including the requirement to offer to submit any disputes relating to their services or activities to the jurisdiction of a court or arbitral tribunal in the UK. It is not clear what this would involve in practice, and whether this might require non-UK firms to submit to the exclusive jurisdiction of the UK (or whether firms who were already providing services to UK firms under the existing overseas framework might be required to amend existing documents to reflect this before being allowed to rely on the Article 47 equivalence regime).

In addition to this, depending on the approach that the UK takes to assessing equivalence, it is unlikely that many jurisdictions will be entirely or even partially equivalent. Because the Article 47 regime is designed to provide more access where the previous regime was restrictive (rather than to replace a flexible regime like the UK overseas regime), this may lead to the odd result that a small number of jurisdictions whose regimes are closest to the UK regime are subject to the narrower and less certain regime under Article 47 while the jurisdictions whose regimes are most different from the UK regime continue to be able to rely on the more flexible and certain overseas persons exclusion. This may also have an impact on the level of cross-border access that those jurisdictions are prepared to offer to UK firms.

Question 6: are there national exclusions / exemptions in other jurisdictions that provide benefits comparable to those provided by the UK's regime?

As every country's cross-border regime is slightly different (and some are radically different) it is difficult to say that any regime is completely comparable to any other. For example, some jurisdictions will offer a flexible cross-border regime in relation to certain services or client types, while others may have a narrower territorial scope than the UK meaning that their exemptions for cross-border services do not need to be as flexible as the overseas persons exclusion.

However, in our experience jurisdictions with open, global financial markets will also have flexible cross-border regimes. For example:

- The Republic of Ireland offers a "safe harbour" for third country firms which operates in a similar way to the OPE. A third country firm that meets certain conditions will be permitted to provide cross-border services to per se professional clients and eligible counterparties without triggering a licensing requirement or being required to apply or register in order to rely on the exemption. Firms that operate under the safe harbour are not required to comply with conduct of business or other obligations under Irish law but remain solely supervised by their home state supervisor.
- Luxembourg allows third country firms to provide services on a cross-border basis so long as the characteristic performance of the activity is not in Luxembourg (this has historically been interpreted to mean that a firm with no physical presence in Luxembourg may provide certain services to Luxembourg clients without triggering a licensing requirement). More recently, Luxembourg has also developed a regime similar to that under Article 47 MiFIR, under which a third country firm may apply to provide investment services to per se professional clients and eligible counterparties where the CSSF has determined that the relevant third country has a licensing regime equivalent to that in Luxembourg.
- Outside of the EU, other jurisdictions also offer access to foreign providers of financial services on the basis of a mutual recognition or equivalence regime. For example, Australia permits foreign service providers to operate in Australia where the foreign provider is subject to a sufficiently equivalent regulatory regime. Recognition of an overseas regulatory regime may be unilateral or based on mutual recognition. ASIC has developed clear principles that set out its decision-making process for recognising an overseas regulatory regime, giving a level of certainty around how these decisions will be made.

- Other jurisdictions offer regimes which are closer to a full cross-border licensing regime. For example, the Netherlands offers a cross-border licensing regime under which a third country firm may obtain authorisation to provide certain activities to clients in the Netherlands. These firms are supervised by the AFM and are subject to conduct of business and other obligations under Dutch law.

Question 7: What changes do you think should be made to the operation of the OPE, and what would be the advantages and disadvantages?

As mentioned in our earlier responses, we do not consider that there is a need for significant changes to the operation of the OPE. It may benefit from some further guidance to clarify its operation, but otherwise our main concerns regarding the complexity of the UK's overseas framework relate to the regime for non-UK financial market infrastructure and the equivalence regimes inherited from EU regulation.

Our key concern with any changes to the operation of the OPE would be that these changes may have unintended consequences for UK firms who currently receive services from and have access to a wide range of international financial markets and that this may reduce the confidence of non-UK firms and financial market infrastructure in the long-term stability of the UK's overseas framework.

Question 8: Which aspects of the overseas framework are relevant to the conduct of your business, how easy they are to use and how well do they suit the nature of your business?

As mentioned in our responses above, we consider that the current regime provides certainty and proportionate regulation on these issues, which are critical to enable global firms to continue to have a strong UK presence as well as to enable local UK firms and corporates to access global derivatives markets. Aside from the issues of complexity discussed above (which primarily arise in the context of overlapping regimes), the framework is relatively easy to use and works well.

Question 9 (e): Please comment on your current and future use of the OPE, ROIE and FPO exemptions specifically, as well as any other specific regimes under the access framework, setting out in particular whether, and if so how, your use of these regimes enables you to manage business between different group entities, for example for risk management, or is used in conjunction with other group entities or structures as an alternative means of access or to expand the range of services that may be offered?

We do not comment on the use of the OPE, ROIE or FPO exemptions by any specific member firm. However, we understand that these regimes are widely used, including to enable UK firms to manage risk between different group entities and also to deal with counterparties and financial market infrastructure outside of the UK.

The availability and flexibility of the OPE supports the liquidity of the London market, allowing trading between UK and non-UK entities market counterparties while offering protection for UK retail clients and individuals. As mentioned above, we consider that the OPE has contributed to the UK's position as a global financial centre and continues to do so, to the benefit of counterparties that have chosen London as their derivatives trading hub.

We would welcome the opportunity to discuss these and any related issues further with you and are also very happy to answer any questions you may have in the meantime.

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