

ATOZ ALERT



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ESMA's opinions to support European supervisory convergence in the Brexit context

Most of the principles invoked by the European Securities and Markets Authority in its recent opinions on the supervisory convergence in the Brexit context are a reinstatement of rules and guidelines already provided for by the relevant European legislation. However, some of its declared expectations in terms of substance, governance or delegation, for instance (highlighted herein), exceed the requirements currently stipulated in the legal texts.

The European Securities and Markets Authority (ESMA) recently released two opinions (one laying out the general principles and the other focused on the investment management sector) to support the supervisory convergence among the European national competent authorities (NCAs) with respect to the relocation of entities, activities and functions in the context of United Kingdom's withdrawal from the European Union (Brexit). The opinions are issued in the context of Brexit which triggers an increasing number of requests for relocation of financial services firms from the UK into the remaining EU 27 Member States (EU27 MS). They are drafted based on the assumption of a "hard Brexit", i.e. where the UK would become a "third country" for the purposes of EU financial service regulations and in the absence of any equivalence regime or special transitional arrangements. The sectorial opinion on investment management concerns management companies of undertakings for collective investment in transferable securities (UCITS), alternative investment fund managers (AIFMs) and self-managed investment companies (hereafter, the Firms).

Here are some highlights of ESMA's general principles and sectorial opinion on investment management:

Authorisation – No derogations, no favours

- Firms applying for an authorisation in the EU27 MS cannot rely on their current authorisation in the UK, nor on the program of operations previously filed with the Financial Conduct Authority (FCA).

- The relocation to an EU27 MS must be driven by ‘objective factors’, i.e. the geographical distribution of activities, investors, the programme of operations, the marketing or promotional arrangements, the language of offering and promotional materials, the distributors’ identity, activities, location.
- NCAs are advised to refuse an authorisation if it appears that an application is made in MS A in order to evade stricter standards of MS B, the greatest part of the activity of the entity being carried out in MS B; this seems to conflict with the freedom of establishment and the freedom to provide services enshrined in the Single Market.

Substance – How many persons?

- A firm’s volume and complexity of activities is likely to trigger the need to have more than two senior managers (as currently provided in the legislation) and a significant activity volume, complex activities or a broad range of businesses will not entitle an entity to operate with minimum operational set-up in the new EU27 MS.
- Moreover, a relocating entity (even one of smaller size applying simple investment strategies and having a limited range of business activities) should hire at least 3 locally-based full-time employees to carry out portfolio management and/or risk management functions and to monitor the delegates.
- A relocating entity should have less staff and functions in the country of origin than in the EU MS to which it migrated.

Governance – Third-party Management Companies under the spotlight

- NCAs are called to scrutinise individuals with a high number of (non-)executive directorship mandates and to make sure that they have sufficient time allocated to the duties arising from them.
- Third-party, independent management companies and Firms offering fund platforms must become better staffed and better equipped with technical resources and more sophisticated governance structures and internal control mechanisms.
- The substance of decision-making should be present in the EU (even when the Firm is part of a larger group).

Delegation – No letter-box, no circumventions

- The delegation of functions and activities outside the EU27 MS must be justified by ‘objective reasons’ – they are not defined in the opinions, but must be described, explained and proved to the NCAs.
- If the Firms invoke cost saving objectives when delegating, they must evidence that the saving realised through delegation exceeds the costs of performing the function internally or monitoring and supervising the delegates on a continuous basis.

- An EU AIF investing in real estate or portfolio companies located in a EU27 MS must prove that the delegation of functions to a non-EU entity to a larger extent is based on objective reasons, despite the fact that the geographical spread of investments is an argument against the delegation.
- Firms should not seek authorisation for the sole purpose of benefiting of the European financial services passport and are advised not to use delegation or outsourcing arrangements or branches in order to extensively perform activities on behalf of the EU27 firm from outside the EU.
- The Letter-box test applies to each individual fund and not to a Firm's activities as a whole.
- NCAs must verify if the use of investment advisers circumvents or not the delegation rules.
- The Firms appointing third parties to provide investment advice will need to perform and document their own qualified analysis after receiving the investment advice and before concluding a transaction. Firms are warned that a formal check limited to verifying if the proposed investment would breach the investment restrictions is not enough and it would constitute delegation.
- The delegation arrangements must comply with the remuneration rules and must disclose delegate's remuneration of the staff involved in the performance of the delegated functions.
- A single person may not be enough to monitor delegation, in ESMA's opinion.
- Non-EU branches of EU authorised Firms must not perform material functions or provide material services back into the EU, but they must be related to the EU Firm's activity in the non-EU jurisdiction (facilitate access to market, serve as a dispute resolution agent, etc.).
- When core investment management functions are delegated to a UK firm from day one following the UK's withdrawal from the EU, the delegate must be authorised for asset management and there must be a cooperation agreement in place between FCA and the relevant NCA (the CSSF in Luxembourg).

Conclusion

UK and non-UK firms from outside the EU alike will need to seek advice and assistance from their advisers and to thoroughly prepare their relocation or set-up into an EU27 MS, so as to find or move the right staff, to design the optimal operating model and to manage the spread of their activities across multiple jurisdictions.

Can we help? Do you have further questions?



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