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ESMA issues opinion on supervisory convergence

The European Securities and Markets Authority (“ESMA”) released an [opinion](#) today on supervisory convergence in the context of the UK withdrawing from the European Union (“EU”). The opinion is addressed to national regulators, and contains nine principles for national regulators to follow when authorising and supervising firms that are seeking to re-locate in the EU from the UK. ESMA has issued the opinion in anticipation of UK firms establishing EU offices to maintain access to EU passports and financial markets and relying on outsourcing or delegation arrangements to UK-based affiliates. ESMA gives its opinion on the basis that the UK will be a “third country” (i.e., no longer part of the EU) after its withdrawal from the EU, without reference to any bespoke arrangement on financial services that may be agreed between the UK and the EU.

The principles are as follows:

No automatic recognition of existing authorisations. There should be no “automatic” authorisation of firms re-locating to the EU or grandfathering of UK authorisations. As expected, new authorisation will be needed.

Rigorous and efficient authorisation by competent authorities. National competent authorities should require detailed information in applications for authorisation, and should scrutinise the applicant’s governance structure, human and technical resources and outsourcing and delegation arrangements. With an eye to regulatory arbitrage, ESMA also states that competent authorities “should not grant authorisations where the activity carried out indicates clearly that the entity has opted for...a Member State to evade the stricter standards in another Member State within the territory of which it intends to carry on the greater part of its activities”.

Objective reason for re-location. ESMA states that competent authorities should check that the planned EU activity is the “main driver” for the relocation of entities, activities and functions.

Avoiding letter-box entities. A letter-box entity is, broadly speaking, an entity which outsources or delegates more functions than it retains. According to the opinion, competent authorities should reject an application where “extensive use of outsourcing and delegation is foreseen with the intention of benefiting from an EU passport, while essentially performing all substantial activities or functions outside the EU.”

Outsourcing to third country entities only under strict conditions. ESMA reiterates the key condition for outsourcing, namely that EU firms can outsource or delegate only tasks or functions, but not responsibilities. The opinion also re-iterates that some financial services directives contain conditions on outsourcing to third countries, such as regulatory co-operation agreements.

Meeting substance requirements. ESMA gives some significant colour on the substance requirements it expects competent authorities to impose on re-locating firms, stating that certain key activities and functions should be present in the EU and that “the substance of the decision-making” cannot be outsourced, including



internal control functions, IT control infrastructure, risk assessment, compliance functions, key management functions and “sector-specific functions.”

Sound governance of EU entities. ESMA expects that the key executives and senior managers of EU authorised entities are employed in the Member State in which the re-locating firm is established, and will work there to a proportionate degree (if not full-time), and that competent authorities assess the knowledge, experience and “appropriate presence” of executive board members and senior managers.

Competent authorities must effectively supervise and enforce EU law. Competent authorities should continually supervise firms, in particularly outsourcing and delegation arrangements, with the power to perform on-site inspections of outsourced or delegated activities or functions.

Effective monitoring by ESMA. ESMA will establish a forum for reporting and discussions amongst national competent authorities regarding firms re-locating to the EU, to encourage consistent approaches by competent authorities.

Although the opinion in part re-states existing EU law on areas such as outsourcing and delegation, it does contain new detail on these requirements, and the establishment of a forum of competent authorities is a new initiative. ESMA addresses the opinion to national regulators under a specific power granted to it to build consistent supervisory practices in the EU. The opinion is not binding, but is intended to influence national regulators’ practices. Unlike for ESMA guidelines, ESMA does not require national regulators to confirm whether or not they intend to comply with the opinion.

ESMA will issue a further opinion on this topic specifically addressing asset managers.

For more detailed analysis of the issues, please contact your usual Ropes & Gray partner. For additional Brexit resources, please refer to the Ropes & Gray [Brexit](#) webpage.

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