



ESMA Sets Out Principles on Supervisory Approach to Relocations from the UK

On 31 May 2017, the European Securities and Markets Authority (“ESMA”) published an [opinion](#) (“**Opinion**”) which sets out general principles on supervisory approach in relation to relocations of entities from the United Kingdom (“UK”) to the remaining 27 European Union (“EU”) members states (“EU27”).

This Opinion has been issued in response to increased requests from the financial market participants seeking to relocate to the EU27 and comes after the time when some national regulators raised concerns that some EU member states could allow for the creation of letterbox entities in order to attract UK based asset managers. These concerns are especially relevant where UK based entities may seek to relocate to the EU27 by relying on the outsourcing or delegation of certain activities or functions to UK based entities including affiliates. By issuing its Opinion, ESMA has delivered a clear message: new authorisations must comply with EU law in a coherent manner across all EU27 and any outsourcing or delegation arrangement from entities authorised in the EU27 to third country entities should be “*strictly framed and consistently supervised*”. Such outsourcing or delegation arrangement should not result in those entities becoming letterbox entities.

The Opinion is addressed to the national competent authorities (“NCAs”) and is aimed at fostering consistency in relation to authorisation, supervision and enforcement.

The Opinion covers activities of alternative investment fund managers (“AIFMs”), undertakings for collective investment in transferrable securities directive (“UCITS”) and investment firms authorised pursuant to markets in financial instruments directive (“MiFID”).

General Principles

In issuing its Opinion, ESMA took the view that the UK would become a third country after its withdrawal from the EU and has set out nine general principles for NCAs on the avoidance of supervisory arbitrage risks:

- **There should be no automatic recognition of existing authorisations.** ESMA stated that there can be no automatic recognition of the authorisation granted by the UK regulator into the EU27 post the UK’s withdrawal from the EU and an entity established in the UK needs to establish itself in the EU27 post Brexit.
- **Authorisations granted by the EU27 NCAs should be rigorous and efficient.** Although NCAs may take some aspects of assessment of third party regulators into consideration (ie, fit

and proper requirements), NCAs should scrutinise the entity's governance structure, human and technical resources as well as outsourcing and delegation arrangements.

- **NCAs should be able to verify the objective reasons for relocation.** The entity's programme of operations should provide a clear justification for relocating to the member state of establishment.
- **Special attention should be granted to avoid letterbox entities in the EU27.** ESMA stated that NCAs should reject any relocation requests where the main intention is to benefit from an EU passport with all substantial activities or functions being performed through third country branches.
- **Outsourcing and delegation to third countries is only possible under strict conditions.** This should be subject to outsourcing or delegation arrangements between the EU NCAs and third country authority.
- **NCAs should ensure that substance requirements are met.** In particular, this implies that certain key activities and functions should be present in the EU27 which cannot be outsourced or delegated outside the EU. These important activities include internal control functions, IT control infrastructure, risk assessment, compliance functions, key management functions and sector-specific functions.
- **NCAs should ensure sound governance of EU entities.** ESMA's expectation is that key executives and senior managers of EU authorised entities are employed in the member state of establishment and work there either on a full time basis or in the case of smaller companies to a degree proportionate to their envisaged role. The NCAs must assess the quality and the appropriate presence of executive board members and senior managers in the member state of establishment in order to ensure that executive board members and / or senior management are able to effectively carry out their responsibilities. These responsibilities should include, but not limited to having sufficient knowledge and relevant experience as well as dedicating sufficient time to fulfil their duties. Risk management capacity of EU entities should also be taken into account and adequate levels of own funds and liquidity should be readily available to them.
- **NCAs must be in a position to effectively supervise and enforce Union law.** This includes ensuring that initial conditions granted on authorisation are met on a continuous basis, including outsourcing and delegation arrangements. This also implies that NCAs can conduct onsite inspections of outsourced or delegated activities or functions without any prior third party authorisation.
- **Coordination to ensure effective monitoring by ESMA.** ESMA is planning to put in place a forum, the Supervisory Coordination Network, in order to allow NCAs to report and discuss cases of relocating UK market participants and to promote consistent decisions taken by NCAs.

Comments

We welcome ESMA's Opinion which clarifies that outsourcing or delegation arrangement to third country entities should not lead to creation of letterbox entities and should be "*strictly framed and consistently supervised*". The Central Bank of Ireland's ("**Central Bank**") recent consultation and guidance on fund management company effectiveness (commonly referred to as CP86) means that

Ireland is well placed to ensure that the Irish authorisation and supervision regime for management companies is compliant with the requirements of the Opinion.

ESMA has indicated that it intends to develop further guidance for asset managers, investment firms and secondary markets to provide sector specific details on the aspects described in the Opinion, and we will keep you informed of further developments.

Please get in touch with your usual Asset Management and Investment Funds Group contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this update.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.

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