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ESAs Report on Cross-Border Supervision of Retail Financial Services

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July 19, 2019 TO: ICI Global Members SUBJECTS: International/Global RE: ESAs Report on Cross-Border Supervision of Retail Financial Services

On July 9, the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA), and the European Insurance and Occupational Pensions Authority (EIOPA), collectively referred to as the European Supervisory Authorities (ESAs), published a joint report on the cross-border supervision of retail financial services (Report).[\[1\]](#) The report explains that, as part of their responsibility to monitor consumer protection developments and financial innovations, the ESAs have noted the continued increase in the cross-border provision of financial services to consumers across the EU, resulting from a combination of the development of the single market in financial services and the digitalization of financial services across the banking, insurance, and securities sectors. From the perspective of the ESAs, while the increase in cross-border provision of financial services has its benefits for consumers – such as fostering competition and expanding the products offered to consumers – it also poses challenges for Member State competent authorities (CAs) that are responsible for supervising those financial institutions and their activities.

Overview of the Report

The Report first describes the main issues that CAs face when they supervise financial institutions that provide financial services across borders. It then provides an overview of the main consumer protection and retail conduct of business rules that apply to the cross-border provision of financial services through a mapping of the relevant legal provisions. The legal mapping is followed by a description of the current framework for cooperation between CAs and proposed high-level principles for cooperation between CAs. The report concludes with the ESAs' main observations from this exercise and recommendations on how to address the issues that were identified.

Main Issues that CAs Face

Based on an assessment of input provided by CAs following a survey performed in February 2017, the ESAs have identified and classified the issues that CAs face in relation to the supervision of cross-border provisions of retail financial services into three different categories: (1) institutional and organisational issues, (2) supervision and enforcement, and (3) regulatory gaps and arbitrage. The Report recognizes that not all issues affect all sectors equally, with some issues relevant only to one sector and others relevant across the

different sectors.

Institutional and Organisational Issues

The main institutional and organisational issues identified in the Report are related to the distribution of responsibilities between the home and host CAs, which is not always clear, and to the notifications and exchange of information between CAs, where passport procedures either are not followed consistently by CAs or the legislation does not provide for the exchange of all the information that CAs may need.

Supervision and Enforcement Issues

The key issues with respect to supervision and enforcement are related to the risk that some CAs prioritise financial institutions that represent a higher risk in their own territories over other financial institutions that locate themselves in a Member State in order to passport services, but do not actually carry out business in the home Member State. The Report notes that this is particularly problematic when the activity of a financial institution is carried out exclusively or almost exclusively on a freedom of services basis outside the home jurisdiction. The Report states that the cross-border marketing and selling of UCITS is an example of such a risk of prioritization because, given that the supervisory competence of the host CA is limited, it may be difficult for the CA to determine whether the UCITS or its management companies is acting in line with the relevant regulatory requirements, despite having grounds for suspicion. The Report further states that the host CA would probably need the help of the home CA to make such a determination, but if the UCITS is only marginally offered and sold in the home Member State, the home CA may have little incentive to assign adequate resources to the supervision of such UCITS.

The Report also identifies as issues the use of third parties by financial institutions in host Member States and the aggressive and misleading cross-border marketing of complex financial products to retail clients.

Regulatory Gaps and Regulatory Arbitrage

The Report identifies as an issue considerable differences in the implementation of EU legislation at national level due to the insufficient harmonization and/or clarity of some EU laws, which, in the ESAs' view, hinders a level playing field for financial institutions and creates the risk of regulatory arbitrage. The Report also explains that there are circumstances where a financial institution that markets or sells products in a host Member State may not be subject to the same conditions and/or restrictions as a local financial institution that is also marketing and selling the same products in that jurisdiction because the local financial institution is subject to certain restrictions imposed by its CA at the time of authorization.

Legal Mapping

The ESAs carried out a general mapping of the main Level 1 provisions for the different financial institutions operating across borders, identifying those provisions that are related to: (1) definition of cross-border provision of services, (2) passporting (services and products), (3) notifications and exchange of information, (4) home and host responsibilities, (5) information reporting requirements for statistical/supervisory purposes for the host CAs, (6) simultaneous exercise of the freedom to provide financial services (FPS) and the right of establishment (ROE), (7) exercise of the FPS by a branch or another establishment in a host Member State for providing services in a third Member State, and (8) "jurisdiction

shopping.”

Report contains in Appendix 1 the identified provisions of the legal acts that were reviewed and in Appendix 2 an analysis of those provisions. The Report acknowledges that some of the most recent legislation, such as MiFID2, PSD2, the PRIIPs Regulation and the IDD, which started to apply at different points in 2018, will be helpful for tackling some of the issues that have been identified.

Cooperation Between Home and Host CAs

As part of the legal mapping exercise, the ESAs also reviewed the relevant EU directives and regulations to identify those provisions that are related to cooperation between home and host CAs. The Report explains that, while all the Level 1 texts contain some provisions regarding cooperation between CAs, the number of provisions and the level of detail of those provisions differ considerably from one text to another. A table with an overview of the relevant provisions and an in-depth description of the main requirements on cooperation between home and host CAs for the different legal texts is provided in Annex 3 and 4.

As part of the review of the current requirements in place for cooperation between home and host CAs, the ESAs identified fourteen high-level principles that are embedded in the majority of the Level 1, Level 2, and Level 3 texts and that, in the view of the ESAs, can form the basis for any further development (particularly in the banking sector). The Report states that CAs should aim to comply with the high-level principles without prejudice to the applicable sectoral legislation or cooperation agreements currently in place. The topics covered by the high-level principles are: (1) contact points, (2) requests for cooperation or exchange of information, (3) reply to a request for cooperation or exchange of information, (4) request to open an investigation or carry out an on-site inspection, and (5) settlement of disagreements.

Recommendations for EU Co-legislators and CAs

The report concludes with the ESAs observations and recommendations for EU co-legislators and, separately, for CAs.

The recommendations for EU co-legislators include the following:

- Consider reinforcing the harmonisation of Level 1 provisions governing the marketing and sale of services and products, especially in the banking sector, and to clearly set out and allocate responsibilities between the home and host CAs with regard to the application of consumer protection and conduct of business provisions.
- Provide more clarity on when activities carried out through digital means fall under passporting (either within the remit of the FPS or of the ROE) due to the lack of definition of cross-border provision of financial services and in the light of the continuous growth in the digitalization of financial services.
- Consider possible ways to overcome supervisory difficulties that CAs face when there is simultaneous exercise of the FPS and the ROE, or when a branch exercises the FPS in another Member State.
- Encourage co-legislators to follow the path laid out in MiFID2, the Mortgage Credit Directive and PSD2, which aims to prevent financial institutions opting to comply with the legal system of one Member State in order to avoid stricter standards in another Member State where it intends to carry out or does carry out the greater part of its activities.
- Consider requiring that a passport regime include the proportionate provision of

information on whether the products and/or services covered by the notifications are, in practice, provided.

- Consider the high-level principles on cooperation identified in the Report as the basis for any new legislation or possible amendment to current legislation.
- Consider clarifying the diligences that a home CA should undertake prior to granting a passport.
- Introduce, where relevant, supervisory powers in the event of significant divergences from its initial business plan, including the withdrawal of a granted authorization if the relevant services and activities are not provided for a given period of time.

The most relevant recommendations for CAs are to:

- Ensure an effective collaboration and regular exchange of information to establish appropriate preventive measures and to identify at an early stage any potential issues.
- Follow the high-level principles on cooperation set out in the Report in the absence of any detailed requirements on cooperation in the applicable legislation.
- Liaise with the ESAs to ensure that registers of contact points for notifications and the exchange of information are kept up-to-date, including the accepted means of communication, in accordance with the relevant sectoral rules.
- Work together with the ESAs to improve the framework for cooperation in consumer protection between CAs, especially in the banking sector.

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endnotes

[1] The Report is *available at* <https://eba.europa.eu/documents/10180/2551996/Final+Report+on+cross-border+supervision+of+retail+financial+services.pdf>.

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