

**MEMO# 34591**

December 15, 2022

## **ESMA Report on Brexit Relocation**

[34591]

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TO: ICI Global Members SUBJECTS: MiFID, EMIR, AIFMD, UCITS V RE: ESMA Report on Brexit Relocation

On December 8, the European Securities and Markets Authority (ESMA) published a peer review report[\[1\]](#) on National Competent Authorities' (NCAs) handling of firms' relocation to the European Union (EU) in the context of the United Kingdom's (UK) withdrawal from the EU.

The peer review was launched to assess how NCAs met their relevant regulatory requirements, which were clarified in the 2017 ESMA relocation opinions, when authorizing relocating entities and activities from the UK to the EU.

This peer review covered the assessment of the following three sectors: (1) fund managers; (2) firms providing investment services and activities or so-called MiFID firms; and (3) trading venues. It focused on NCAs of jurisdictions where most or complex activities were relocated - the Netherlands, France, Germany, Cyprus, Luxembourg and Ireland - and on two areas where there is a need for further convergence - the governance and the substance requirements set for relocating firms.

The report includes findings and recommendations for future ESMA work with respect to each sector in order to achieve greater convergence across the EU. We summarize below the findings and recommendations related to fund managers.

### **Findings With Respect to Fund Managers**

The jurisdictions that were evaluated with respect to fund managers were: France, Ireland, Luxembourg and the Netherlands.

#### **Governance**

In assessing the supervisory approach taken by NCAs regarding the governance of fund managers, the Peer Review Committee (PRC) specifically focused on the supervisory expectations as set out in the peer review mandate and the 2017 ESMA opinion on investment management.[\[2\]](#)

The PRC found that, although all NCAs had in place a supervisory assessment of

governance structures that addressed the requirements to a certain extent, there were nevertheless shortcomings mainly in the supervisory assessments and practices in relation to the governance structures of applicant firms. In particular, the PRC found a lack of a thorough review of conflicts of interest management and related disclosures based on documentary evidence and the strong and independent role of internal control functions within the organization.

The report further states that the PRC also observed shortcomings regarding the assessment of the principle of proportionality, with some NCAs using largely divergent quantitative thresholds that were up to 20 times higher compared to others. The PRC therefore concluded that further work is required with respect to the application of the proportionality principle to ensure supervisory convergence and a level-playing field for market participants across Member States.

## **Substance**

In assessing the NCAs' supervisory approach towards substance, the PRC focused on the supervisory expectations as set out in the peer review mandate related to the adequacy of senior managers and human and technical resources, as well as delegation arrangements and the monitoring of white label service activity.

The PRC found that the supervisory practices of Ireland, Luxembourg, and the Netherlands did not meet supervisory expectations. Specifically, the PRC concluded that NCAs had authorized applicant firms for which the overall number of senior managers and human and technical resources appeared insufficient, with only France fully meeting the supervisory expectations in terms of the supervisory assessments concerning the adequacy of senior managers and human and technical resources.

In addition, the PRC also concluded that none of the four NCAs met supervisory expectations in relation to delegation arrangements. Specifically, it concluded that none of the NCAs performed a comprehensive review of delegation arrangements, in particular the objective reasons for delegation and compliance with due diligence requirements.

With respect to the monitoring of white label service activity, the PRC assessed how NCAs addressed the supervisory expectations set out in the ESMA investment management opinion. The assessment was only relevant to Ireland and Luxembourg, with the PRC finding that Ireland conducted supervisory work in line with the supervisory expectations, while Luxembourg did not specifically monitor this sector during the review period and therefore was not in a position to provide precise information. However, the report further qualified that Luxembourg conducted a survey in the second quarter of 2021 (after the review period) on investment fund managers providing white label services, focusing on the business increase and the investments in human and technical resources.

## **Recommendations With Respect to Fund Managers**

With respect to governance, the PRC has recommended that the NCAs introduce a more systematic and thorough approach to reviewing potential and actual conflicts of interest during the authorization stage and scrutinizing more closely the combination of responsibilities, roles, functions, or reporting lines which may result in a conflict of interest or impair the principle of independence of control functions.

The PRC also recommended that France and Ireland introduce a more systematic and thorough approach to reviewing the key policies and procedures of applicant firms. In addition, the PRC recommended that Ireland and Luxembourg review the current

quantitative thresholds applied to determine proportionality. Further, the PRC recommended that all the NCAs increase the efforts to review the establishment and strong role of internal control functions, verifying in particular the appropriate interaction between portfolio and risk management and sound escalation procedures.

With respect to substance, the PRC has recommended that Ireland, Luxembourg, and the Netherlands introduce a more thorough review of the adequacy of human and technical resources, and that all four NCAs introduce a more systematic and thorough supervisory approach in reviewing delegation arrangements.

With respect to white label service providers, the PRC recommended that Luxembourg monitor its white label industry more closely given the specific supervisory risks posed.

## **Cross-Cutting Issues**

In the report, the PRC identified some cross-cutting issues that merit follow-up work at the EU level to foster supervisory convergence. These are the application of (i) the risk-based approach, (ii) the proportionality principle and (iii) outsourcing /delegation arrangements, which varied significantly across NCAs.

## **Good Practices for Fund Managers**

The PRC also identified certain good practices across the three areas covered in the peer review. The good practices in the supervisory approach of the NCAs related to asset managers were the following:

- Using detailed checklists covering the key legal requirements and paragraphs set out in the ESMA opinions with a view to ensuring comprehensive and consistent supervisory assessments (Netherlands);
- Conducting a detailed review of the envisaged portfolio management process, including the review of detailed order flows (pre-placement, validation, and registration of orders and reconciliation of positions etc.) (France);
- Conducting a comprehensive assessment of the technical resources of applicant firms to obtain a good overview of the various IT tools and systems used by applicant firms and their delegates (France);
- Requiring applicant firms to appoint an independent non-executive director as chair of the board of directors providing for additional escalation possibilities and more independent decision-making processes (Ireland);
- Conducting a thorough review of the risk management process and related documentation particularly through comprehensive and, where possible, standardized assessments (Luxembourg).

The recommendations in the report relate specifically to particular NCAs; however, they are relevant not only to the NCAs that participated in this exercise, but to all EU NCAs. In addition, the findings and recommendations in the report may influence the ongoing negotiations on the review of the AIFMD/UCITS Directives, which include changes to requirements related to fund manager authorization and delegation.

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## Notes

[1] ESMA's report on the peer review into the NCAs' handling of relocation to the EU in the context of the UK's withdrawal from the EU is available at [https://www.esma.europa.eu/sites/default/files/library/esma42-111-7468\\_brexit\\_peer\\_review\\_report.pdf](https://www.esma.europa.eu/sites/default/files/library/esma42-111-7468_brexit_peer_review_report.pdf).

[2] ESMA's opinion on investment management is available at [https://www.esma.europa.eu/sites/default/files/library/esma34-45-344\\_opinion\\_to\\_support\\_supervisory\\_convergence\\_in\\_the\\_area\\_of\\_investment\\_management\\_in\\_the\\_context\\_of\\_the\\_united\\_kingdom\\_withdrawing\\_from\\_the\\_european\\_union.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-45-344_opinion_to_support_supervisory_convergence_in_the_area_of_investment_management_in_the_context_of_the_united_kingdom_withdrawing_from_the_european_union.pdf).

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