

The Chair

**Valdis Dombrovskis
Vice-President in charge of Financial
Stability, Financial Services and
Capital Markets Union
European Commission
200 rue de la Loi / Wetstraat 200
B-1049 Brussels
Belgium**

Ref: MiFID II / MiFIR third country regimes, provision of investment services and activities at the exclusive initiative of the client and outsourcing of functions to third country entities

Dear Vice-President Dombrovskis,

Following the letter that ESMA sent you on November 2017¹, I am now writing to you to contribute to any future work that the Commission may decide to undertake in relation to additional issues concerning some MiFID II/MiFIR requirements on investor protection and intermediaries.

I would like to highlight in particular four items that emerged from discussions at ESMA: (i) the MiFIR regime for third country firms providing investment services and performing investment activities to eligible counterparties and *per se* professional clients²; (ii) the MiFID II regime for third country firms providing investment services and performing investment activities to retail and professional clients on request³; (iii) the MiFID II provisions on third country firms providing investment services and performing investment activities at the exclusive initiative of clients (“reverse solicitation”); and (iv) the requirements for the outsourcing to third country providers of critical or important functions other than those related to portfolio management.

While those issues were initially identified in the context of the discussion on the risks arising from the UK withdrawal from the EU, these issues seem more general and apply beyond the

¹ ESMA70-156-236.

² Professional clients within the meaning of Section I of Annex II to MiFID II.

³ Professional clients within the meaning of Section II of Annex II to MiFID II.

Brexit debate, thereby making it important to address them.

Concerns regarding the MiFIR regime for third country firms providing investment services and activities to eligible counterparties and *per se* professional clients

MiFIR allows third country firms to provide investment services and to perform investment activities to eligible counterparties (ECP) and to *per se* professional clients throughout the Union upon the conditions (*inter alia*) that an equivalence decision is adopted by the European Commission and that the relevant firms are registered in the register of third-country firms kept by ESMA (Articles 46 to 49 of MiFIR).

The equivalence decision adopted by the European Commission aims at assessing that the legal and supervisory arrangements of a third country ensure that firms authorised in that third country comply with prudential and business conduct requirements which have equivalent effect to MiFIR, MiFID II and CRD IV requirements (and relevant implementing measures). As a consequence:

- third country firms registered by ESMA are not required to comply with any organisational or conduct of business rules stemming from MiFID II and MiFIR when interacting with ECP and *per se* professional clients established or situated in the Union;
- these firms are not subject to the direct supervision and enforcement of ESMA or any national competent authority in the Union.

According to the MiFIR third country regime, in the absence of an equivalence decision from the Commission or where such decision is no longer in effect, Member States may allow third country firms to provide investment services and activities to ECP and *per se* professional clients in their territories in accordance with the applicable national regime.

ESMA is aware that the European Commission adopted a proposal on the new prudential requirements for investment firms on 20 December 2017 that, amongst other things, includes targeted changes to the existing equivalence regime for third-country firms under Articles 46 and 47 of MiFIR. In this context, the proposal introduces (*inter alia*) an obligation for third country firms registered in the ESMA register to submit an annual report to ESMA on their activity within the Union and a more detailed and granular process for the assessment of the equivalence in relation to systemic investment firms.

Although the proposal already aims at strengthening the process and the final result of the equivalence assessment, the framework regarding the supervision and the enforcement with regards to third country firms operating within the Union may need further improvements.

ESMA believes that the MiFIR regime does not ensure a consistent and convergent level of protection to investors interacting with third country firms and therefore we would like to support the European Commission in any analysis concerning any further harmonisation regarding the

rules applicable to third country firms providing investment services to ECP and *per se* professional clients. Possible options to consider are:

- Ensuring that third country firms carrying out services and activities in the Union directly comply with relevant MiFID II / MiFIR provisions when services (or, where relevant, certain services such as investment advice) are provided to ECP or *per se* professional clients and that some direct supervisory powers are exercised by NCAs in the Union;
- Improving the existing regime concerning TC firms registered in the ESMA register and the withdrawal of such firms from the register. In this respect, the above mentioned Commission proposal to require third country firms registered in the register to submit to ESMA an annual report goes in the right direction but it should be complemented by the obligation for third-country firms to indicate precise information on the Member States where they are active in order to allow ESMA to share the report with relevant NCAs as well as by the concrete possibility to act upon this report, for example by allowing the request of additional information or clarifications to TC firms. Another supervisory aspect concerns the possibility for a third country branch established in a Member State to provide services across the EU in accordance with Article 47(3) of MiFIR; in this case, a strengthened cooperation framework among NCAs could be required (instead of the optional cooperation agreements currently envisaged by MiFIR).

Concerns regarding the MiFID II regime for third country firms providing investment services and activities to retail and professional clients on request

While the MiFIR regime for the provision of investment services to ECP and *per se* professional clients is subject to a pan-European framework that requires at least (and *inter alia*) the registration in an ESMA register and the adoption of an equivalence decision and cooperation arrangements between ESMA and the relevant third-country competent authority, the MiFID II regime on the provision of investment services to retail clients is fragmented across the EU.

MiFID II merely empowers Member States to require the establishment of a branch for third-country firms intending to provide investment services and to perform investment activities to retail clients (and professional clients on request) in their territories and provides, where Member States opt for such a solution, for a minimum common regulatory framework with respect to the requirements applicable to those branches (Articles 39 to 43 of MiFID II). As said, this option is discretionary and left to national legislation. In any case, the provision of services by TC firms to retail clients remains based on national regimes and does not lead to any passport.

The lack of additional harmonisation in the regime concerning third country firms interacting with retail clients in the EU may pose the risk of legal uncertainty and regulatory and supervisory arbitrage between jurisdictions with potential detrimental implications for investors.

The European Commission may therefore wish to consider the opportunity for further harmonisation of the national regimes applicable to third country firms providing investment services to retail clients in the EU. Please note that the same issues emerge in relation to the provision of services to ECP and per se professional clients, until the EC has declared the equivalence of a certain third country; until that moment, and for three years after any assessment of equivalence (Article 54, paragraph 1, of MiFIR), the applicable TC regimes remain the national ones, without any harmonisation across the EU.

Third country firms providing investment services and activities at the exclusive initiative of EU clients (“reverse solicitation”)

The new regime established under MiFIR and MiFID II also introduced the possibility for third-country firms to provide investment services to clients without being subject to the relevant framework if the service is initiated at the client’s own exclusive initiative (so called “reverse solicitation”). As a consequence, no investor protection rule would apply to the provision of such services.

ESMA has already provided clarifications, through Q&As, on some parts of the framework regulating reverse solicitation⁴.

However, it can be argued that allowing clients, and especially retail clients, in the EU to interact with third-country firms in a context where the MiFID II regulatory and supervisory framework does not apply in its entirety could be a source of legal uncertainty and potential detriment for them. Therefore, considering the importance of this issue, particularly in the context of the UK withdrawal from the EU, ESMA recommends to consider reviewing the MiFID II framework in order to mitigate the effects of reverse solicitation. While acknowledging the complexity of the issue, options include: (i) the explicit obligation for TC firms to demonstrate to supervisory authorities in the EU, upon request, the client’s initiative; (ii) the submission of any dispute to EU Courts and dispute-resolution bodies, upon client’s request, even in case of reverse solicitation; (iii) the possible reassessment and clarification of existing provisions on reverse solicitation (for instance, clarify that the reverse solicitation for retail clients should be assessed on a transaction by transaction basis and the specification of the notion of “new categories of investment products and services” to limit the scope of services that can be provided by third country firms upon the clients’ initiative).

Investment firms outsourcing critical or important functions other than those related to portfolio management to third country providers

As underlined in the ESMA Opinion on “supervisory convergence in the area of investment firms” (ESMA35-43-762), the choice of investment firms established in the Union to outsource critical and important functions to third country entities, which is permitted, may make the

⁴ See ESMA “Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics” (ESMA35-43-349), Section 13 on provision of investment services and activities by third country firms.



supervision of the outsourced functions more difficult and it could also exacerbate the risk of establishment of letter-box entities consisting in firms which are formally established within the territory of a Member State but whose activities are actually performed outside the Union.

MiFID II confirmed the approach adopted under the previous MiFID framework and allowed firms to outsource critical and important functions upon certain conditions, which have become stricter under the new framework (Article 30-32 of the MiFID II Delegated Regulation, No. 565/2017).

ESMA would like to mention that MiFID II provides for a more stringent regime for the outsourcing to third country entities solely in relation to the outsourcing of functions related to the investment service of the portfolio management (Article 32 of the MiFID II Delegated Regulation, No. 565/2017). In this case, the outsourcing is subject (*inter alia*) to the existence of an appropriate cooperation agreement between the EU competent authority of the outsourcing firm and the third country supervisory authority of the outsourcer.

With a view of facilitating supervision and ensuring a higher level of investor protection, ESMA suggests that the outsourcing of critical and important functions to third country entities should be subject to a stricter regime under MiFID II. To this end, ESMA would therefore support any initiative of the Commission aimed at clarifying and strengthening the existing requirements by, for instance, including in the MiFID II delegated regulation n. 2017/565 additional provisions aiming to avoid the establishment of letter-box entities similarly to requirements provided under the current AIFMD framework. In this respect, Section 8 of Chapter III of the AIFMD Delegated Regulation, No. 231/2013, could provide a good basis for further developments in the MiFID II framework.

ESMA stands ready to discuss the content of this letter with you and the services of the Commission.

Sincerely,

Steven Maijor

cc.: Roberto Gualtieri MEP, Chair of the Committee on Economic and Monetary Affairs, European Parliament

Hartwig Löger, President of the ECOFIN Council, Council of the European Union

Jeppe Tranholm-Mikkelsen, Secretary-General of the Council of the European Union

Olivier Guersent, Director General, DG Financial Stability, Financial Services and Capital Markets Union, European Commission