A Brussels Briefing

New EU Regulatory Initiatives

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A distinctly digitally-focused Estonian EU Presidency

…promoting a digital Europe and free movement of data…e-commerce, e-services benefiting citizens…

- **Brexit** – ongoing, uncompromising negotiation positions with European Council and EU Parliament (EP)

- **Re-energising the Capital Markets Union (CMU)**
  - **Securitisation regulation** – risk-retention (5%), no 3rd country originators, ban on re-securitisations and self-certified mortgages, restricted to institutional investors
  - **Non-bank funding -** promoting private equity and debt, removing tax biases on debt, lower SII capital charges on infrastructure investments, crowdfunding, block-chain IT
  - **Removing post-trade barriers** – clearing, settlement & collateral management, on cross-border trades

- **Revised resolution regime –** a new statutory category of unsecured debt, but Council unsatisfied with handling of bank failures in Italy and Spain by SRB and EC…

- **Completing the post-crisis regulatory agenda** – regulatory technical standards, Level III guidance on MiFID II, IDD and PRIIPS – all before 1Q 2018!

Estonia EU Priorities (July-December 2017)…

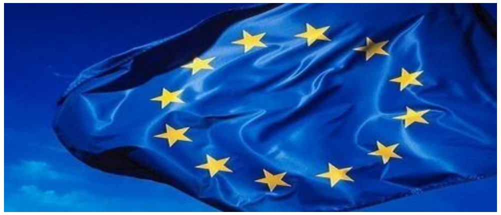
- ❑ protecting and promoting the EU's four freedoms – free movement of goods, persons, services and capital
- ❑ making sure that providing services and starting a business in the EU is as easy as possible, and advancing trade negotiations
- ❑ creating new funding opportunities for companies and ensuring a stable banking sector
- ❑ establishing a stable and well-functioning electricity market and empowering consumers
- ❑ ensuring fair competition by preventing tax evasion

A busy summer EU moves to centralize authorisation, supervision and intervention in the banking & non-banking space

...Implications for asset managers, AIFMs, central-counterparties, insurers, contracts, and funds

EC Proposed revised CCP Regime (27 June 2017)

- Strengthening ESMA powers to authorise, monitor, supervise all CCP's – domestic and 3rd country
- Creation of a CCP Executive Session within ESMA + relevant central bank, with decision-making powers
- A two-tier assessment systems to determine if 3rd county CCPs are systematically important
- ESMA powers to designate CCPs as falling short of risk-mitigation rules, resulting in need to relocate CCP to EU27 state..
- Extra-territoriality via "substituted compliance" model



EC Proposal to strengthen ESA's (20 September 2017)

- ESA's acquire day-to-day powers over NCA's
- NCA's produce annual work programme aligned with ESMA supervisory (convergence) plans
- ESA's granted oversight of all significant firms' plans to outsource/delegate/transfer risks to non-EU jurisdictions
- EIOPA to authorise and ensure convergence of insurers internal models used to calculate capital requirements

- Extend DIRECT SUPERVISORY powers over specific areas of capital markets - highly integrated, cross-border in nature, regulated by directly-applicable EU law:
  - Critical benchmarks
  - Data Reporting services
  - Market Abuse
  - Prospectuses
  - EU capital (EuVECA), social entrepreneurship (EuSEF) and long-term investment (ELTIF) funds
  - Product intervention powers

ESMA Opinion on relocation of activities, funds and functions, post-Brexit

…Critical points (13 July 2017)

- ❑ Review relocation requests: governance, HR + IT resources, outsourcing arrangements, geographical distribution of activities, marketing, identity of distributors, etc.
- ❑ Use AIFMD delegation rules (not UCITs rules) – details the functions that <u>must</u> be performed by AIFM's: *inter alia*, portfolio management, and risk management, marketing, record keeping, valuation & pricing
- ❑ Will the group structure of the authorised entity constitute an obstacle to their effective exercise of supervisory functions?
- ❑ Not delegate investment management functions significantly exceeding functions performed internally
- ❑ Not delegate portfolio management & risk management functions for a particular fund in their entirety even where they perform such functions for other funds.

Laying down the ground rules for national supervisors (NCA's)…

- ❑ No automatic recognition of existing authorisations
- ❑ Authorisations granted by EU27 NCAs should be rigorous and efficient.
- ❑ NCAs should be able to verify the objective reasons for relocation
- ❑ Special attention should be granted to avoid letter-box entities in EU27.
- ❑ Outsourcing and delegation to third countries is only possible under strict conditions.
- ❑ NCAs should ensure that substance requirements are met.
- ❑ NCAs should ensure sound governance of EU entities.
- ❑ NCAs must be in a position to effectively supervise and enforce EU law.
- ❑ Coordination to ensure effective monitoring by ESMA.

ESMA…"whilst back-office functions could be outsourced to non-EU entities… marketing and the performance of underwriting/placing services or …execution services (including client facing and risk management functions) should in principle be performed <u>internally</u> by the investment firm or EU service providers".

EC review of Financial (and non-financial) Conglomerates

…growing complexity and many remain outside the scope of the SSM

Threshold 1	The ratio of the balance sheet total of the regulated and unregulated financial sector entities in the group to the balance sheet total of the group as a whole should exceed **40%** (significantly financial)
Threshold 2	For each financial sector the average of the ratio of the balance sheet total of that financial sector to the balance sheet total of the financial sector entities in the group and the ratio of the solvency requirements of the same financial sector to the total solvency requirements of the financial sector entities in the group should exceed **10 percent** (significant in both sectors).
Threshold 3	The balance sheet total of the smallest financial sector in the group exceeds **Euro 6 billion** (significant cross-sectorial activities).
NCA discretion	Supervisory authorities may waive the requirements of FICOD if a financial group meets only 1 of either Threshold 2 or 3 and they consider the application of the FICOD requirements to be unnecessary or inappropriate. …<u>EC envisage NO change in the thresholds, but…</u> ➢ Threshold 3 not risk-sensitive enough ➢ Does not capture cross-sectoral activities, i.e. asset management, non-financial entities…

- ❑ increasingly complex entities within FICO's, i.e., sub-group within a complex group qualifies as a FICO
- ❑ Intertwining of financial and non-financial entities, some regulated, others not, with cross-border activities
- ❑ Too much NCA discretion: FICOD allows waivers
- ❑ Can NCA's capture the ultimate responsible entity – FICOD does not designate a single point of entry
- ❑ **Mixed Financial Holding Companies** – not regulated under FICOD
- ❑ **Mixed Activity Holding Company, with** a financial conglomerate, but predominately non-financial in nature – supervisory challenge on boundary, subject to (judgemental) size metrics.
- ❑ Non-EU FICO's with predominately insurance activities not SSM-supervised

European Commission

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