

# Proposals for reform of ESMA, and its potential impact for asset managers

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With various substantive initiatives being run by ESMA, there is keen interest in the Proposal published by the European Commission in September for the review of the EU supervisory framework and, in particular, of the European Securities and Markets Authority ("ESMA") with a view to delivering the first steps towards a single Supervisor by 2019. Brexit may be one driver behind the proposals, given that the UK has always strongly opposed further integration, but one suspects that the moves will not suit some of the remaining EU 27.

The key message is clear: centralisation of the European Regulators is the objective with the justification being that a quite strong and increasingly integrated financial supervision will play a key role in delivering the benefits and managing the challenges related to the further integration of EU financial markets, the development of financial technologies and the role of the financial sector in supporting sustainable economic development.<sup>1</sup>

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## Direct supervision

The Commission has announced proposals for "*strengthened supervision as a first new priority to accelerate market integration.*"

The Commission Communication indicates that direct supervision by ESMA is proposed as follows:

Area	Legislation	European Securities Markets Authority direct supervisory powers for EU entities	European Securities Markets Authority powers for third country entities
Capital market entry	Prospectuses	Approval of certain categories of prospectuses by EU issuers	Approval of all prospectuses drawn up under EU rules by third country issuers
Capital market actors	Harmonised collective investment funds (EuVECA, EuSEF and ELTIF)	Authorisation and supervision of funds which are regulated at the EU level	N/a
Capital market infrastructure	Central Counterparties (CCPs)	Supervisory powers in relation to CCPs (Commission proposal of June 2017)	Recognition and supervisory powers for third country CCPs (already existing; reinforced in Commission proposal of June)
Capital market data & information	Credit Rating Agencies (CRAs)	Registration and supervision of CRAs (already existing)	Endorsement of third country CRAs (already existing)
	Trade Repositories (TRs)	Registration and supervision of trade repositories (already existing)	Recognition of third country TRs (already existing)
	Data reporting services providers	Registration and supervision of data reporting service providers	N/a
	Benchmarks	Supervision of critical benchmarks	Endorsement and supervision of third country benchmarks

<sup>1</sup>Paragraph 1 Communication from the Commission to the European Parliament the Council of the European Central Bank of the European Economic Social Committee and the Committee of the Regions Brussels 20 September 2017: [Reinforcing integrated supervision to strengthen the Capital Markets Union and financial integration in a changing environment \(Com \(2017\) 542 final\)](#).

In addition, there will be Commission legislative proposals to review the potential treatment of investment firms and, as part of that, there is an intention to align the regulatory and supervisory treatment of certain large investment firms with the one applying to large credit institutions. This will include a requirement that such firms established within Member States participating in the Banking Union can become subject to supervision by the European Central Bank in its advisory capacity – the Single Supervisory Mechanism, as they call it.

## Upgrading the ESAs framework

There is a wider plan for completing Europe's Economic and Monetary Union (see the Reflection Paper on the deepening of the Economic and Monetary Union (Com (2017) 291 of the 31 May 2017). For the present though, the formal proposal published on 20 September 2017 is intended to *"adjust and upgrade the ESAs framework to ensure they can assume and enhance responsibility for financial market supervision."*

The Commission's Proposal document states that the decision of the UK to leave the EU reinforces the challenge for supervisory arrangements within the remaining EU 27. The future departure of the EU's currently largest financial centre means that the EU 27 capital markets need to develop further and supervisory arrangements must be strengthened to ensure that financial markets continue to support the economy on an adequate and sound basis.

The Proposal sets out three objectives:

### Improved powers:

Where existing powers of the ESAs have proven partially insufficient and unclearly defined – for example on the consistent application of EU law, the drafting of technical advice or the provision of ongoing support to equivalence decisions – they must be strengthened and improved. As a result more common direct supervision in targeted areas is thought necessary.

Similarly ESAs should be more involved in the authorisation and supervision of entities from non-EU countries that are active in the Union – a clear reference to third country activities.

### More effective governance:

There is a desire to establish more effective governance of the ESAs. The Proposal refers to the "inherent tension" between the

European mandate of the ESAs and the national mandate of the Competent Local Regulatory Authorities that are members of the ESA boards.

There is to be an independent Executive Board with full time members replacing the current Management Board. There will also be adjustments to the composition of the Board of the Supervisor. The Chairperson's powers will also be enhanced whilst the Board of the Supervisors will remain as the main body of the ESAs in charge of overall guidance and decision making, but there will be a change to the composition of the Board of the Supervisors to include fulltime members of the Executive Board although without voting rights.

### Appropriate funding base:

The ESAs need an appropriate funding base which allows them to allocate resources in relation to their needs to fulfil their objective.

Detailed legislative proposals were set out in the September accompanying the Communication, setting out next steps for the EU initiative to reinforce supervisory framework.<sup>2</sup>

## Likely impact?

If followed through, these proposals could add to the uncertainties as to how business most notably in Luxembourg and Dublin, but potentially in other European Member States, might develop in the future. Remember that for asset managers in particular, these proposals come in addition to the specific Opinions on delegation in the investment management and funds sector published in May and July. Should ESMA have greater powers, these Opinions have a greater chance of being followed through to the potential detriment and/or hindrance of third country investment managers. The issues for delegation and outsourcing to third countries will be a problem for the UK once it becomes a third country but it is an immediate problem for all manner of outsourcing to firms located outside of the EU at present.

For those in the financial services arena, the key concern is perhaps not therefore the details of the reform but the impact which the emphasis of that reform will bring: centralisation of powers and perhaps consequent removal of powers from some of the local regulators. Just taking the notion of the proposal confirming in ESMA the direct supervision of EuVECAs and EuSEFs and ELTIF funds gives an indication of the potential direction of travel.

<sup>2</sup>[European Commission Proposal for a Regulation of the European Parliament and of the Council amending various documents: Com \(2017\) 536 final](#)

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