

Client Update

First Step in Shift from National to Central European Supervision: Commission Proposal to Enhance ESMA's Powers

On 20 September 2017, the European Commission took what may be the first step towards a more centralised European financial supervisory system by publishing a proposed regulation, which, if adopted, would become directly effective in all EU Member States. Importantly, the proposed rules would give the European Securities and Market Authority (ESMA) new powers to intervene in European financial supervision by national regulators.

DELEGATION OF FUNCTIONS SUBJECT TO PRIOR ASSESSMENT BY ESMA

The Commission proposes to strengthen ESMA's coordination function to ensure that national regulators properly supervise the delegation of portfolio management outside the EU. Key points of the proposed new rules are:

- Delegations by alternative investment fund managers (AIFMs) or investment firms (e.g., investment advisors) to non-EU entities would be subject to review by ESMA if they relate to a material part of their activities or any key functions.
- ESMA would be granted new powers to intervene, and to ask national regulators to reject authorisation for newly set up AIFMs, if ESMA believes that the AIFM is in breach of EU rules on delegation.
- The national regulator would not be able to authorise or register newly set up AIFMs until it receives ESMA's assessment. This assessment would have to be given within two months of the receipt of the notification from the national regulator.
- ESMA would monitor compliance on an ongoing basis. Therefore, national regulators would have to notify ESMA if an existing AIFM wants to delegate material functions to an entity outside the EU. If ESMA concludes that the delegation is not in line with applicable laws, ESMA could recommend that the national regulator act accordingly (e.g., in the most extreme case, withdraw the AIFM's authorisation).

As currently proposed by the Commission, ESMA's recommendations would not be binding. However, a national regulator who chooses not to follow the recommendations would have to give reasons for not complying, which would then be published by ESMA.

In summary, if the proposed rules are adopted in their current form, ESMA will oversee material delegations to non-EU managers. This will probably extend the time required to obtain an authorisation for a new AIFM that proposes to delegate some functions, or to put in place delegation arrangements for an existing AIFM. It could also make such delegation more difficult.

DIRECT SUPERVISION OF CERTAIN FUND MANAGERS BY ESMA

So far, national supervision of fund managers and investment firms has mostly been in the hands of national regulators, while ESMA's main role has been to ensure supervisory convergence by publishing guidelines, opinions and Q&As.

The Commission now proposes to give ESMA more regulatory powers. It suggests that ESMA should become the direct competent authority for investment funds with an EU label, such as venture capital funds (EuVECA), social funds (EuSEF) and special long-term investing funds (ELTIF). In exercising this function, ESMA would both authorise and supervise such fund managers. If EuVECA and EuSEF managers were to exceed the assets under the management threshold under the AIFMD, and therefore require a full AIFMD authorisation, ESMA would also become the competent authority for such fully authorised AIFMs. In those cases, ESMA would therefore replace the national regulator. Under the proposal, ESMA would be responsible for ensuring that these fully authorised AIFMs comply with the national AIFMD-implementing laws in their respective home Member States, as well as the EuVECA or EuSEF Regulations.

This is not the first attempt to increase ESMA's powers. During the revision process of the EuVECA and EuSEF Regulations in 2016, the Economic and Monetary Affairs Committee (ECON) of the European Parliament proposed handing over the responsibility for EuVECA and EuSEF registrations to ESMA. But the European Parliament subsequently rejected that proposal, and national regulators therefore remain the competent authorities for EuVECA and EuSEF managers – for now at least.

NEXT STEPS

The European Parliament and Council will now discuss the Commission's proposal. The proposal will be controversial because it would undermine the competency of national regulators. Therefore, it remains to be seen whether the proposal will make it through the legislative process. If it does, the new regulation could become effective on the 20th day following its publication in the Official Journal of the European Union. And, while most of the new rules in the proposed regulation would apply two years after the regulation becomes effective, the new rules on delegation would apply much sooner: it is envisaged that these would apply three months after the regulation becomes law. If these new rules are

implemented, their success in ensuring that European rules are consistently applied will essentially depend on how ESMA handles its new role in practice.

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Please do not hesitate to contact us with any questions.

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