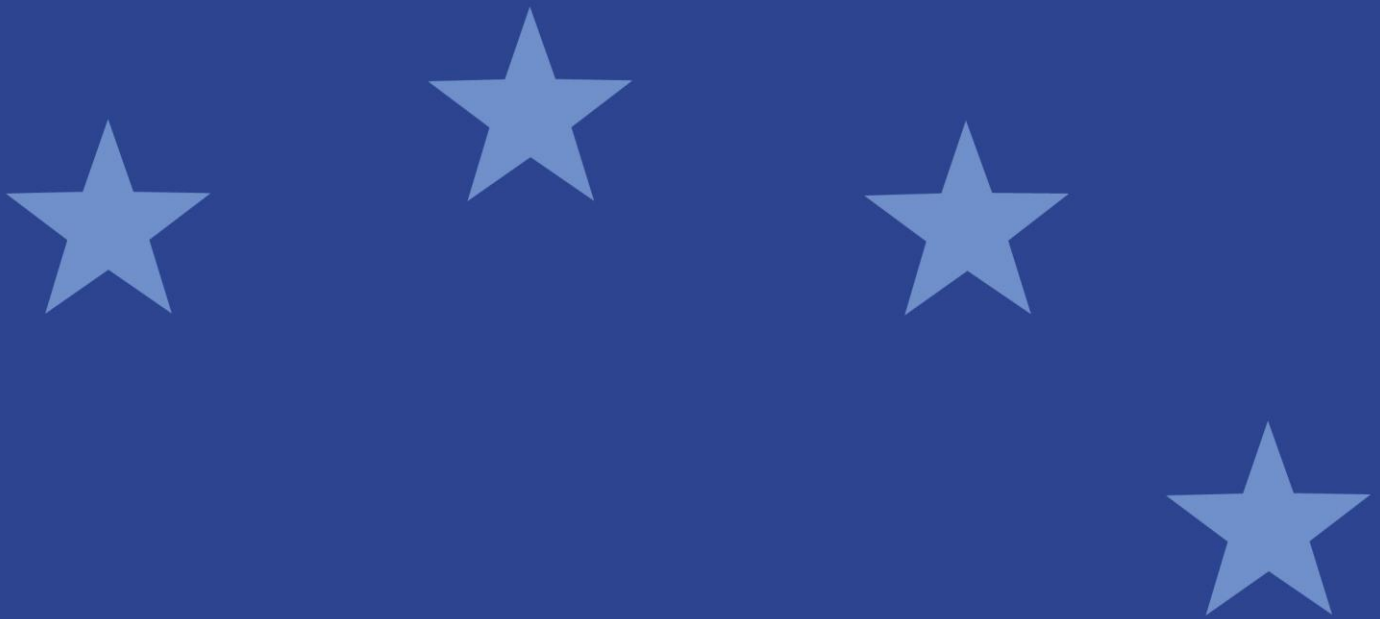




European Securities and  
Markets Authority

# Peer review on supervision of cross-border activities of investment firms

Peer Review Report



10 March 2022  
ESMA42-111-5534

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## List of Terms and Acronyms

|                     |   |
|---------------------|---|
| AFM                 | Autoriteit Financiële Markten   |
| BaFin               | Bundesanstalt für Finanzdienstleistungsaufsicht   |
| BoS                 | Board of Supervisors  |
| CNB                 | Česká národní banka   |
| CSSF                | Commission de Surveillance du Secteur Financier   |
| CySEC               | Επιτροπή Κεφαλαιαγοράς Κύπρου   |
| ESMAR               | ESMA Regulation - Regulation (EU) No. 1095 /2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC |
| Credit institutions | As per definition in Article 4(1)(27) of MiFID II   |
| EU                  | European Union  |
| Firms               | Should be read as referring to both credit institutions and investment firms, unless specifically indicated otherwise.  |
| FPS                 | Freedom to provide investment services mechanism  |
| FTE                 | Full time equivalent. One FTE is equivalent to one employee working full-time   |
| Home NCA            | NCA of the home Member State as defined under Article 4(1)(55) of MiFID II  |
| Host NCA            | NCA of the host Member State as defined under Article 4(1)(56) of MiFID II  |
| Investment firms    | As per definition in Article 4(1)(1) of MiFID II  |
| IPISC               | Investor Protection and Intermediaries Standing Committee   |
| Mandate             | Mandate for this peer review as approved by the BoS on 28 January 2021  |
| MFSA                | Awtoritàgħas-Servizzi Finanzjarji ta' Malta   |
| Methodology         | ESMA Peer Review Methodology (ESMA42-111-4966)  |
| MiFID II            | Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU  |
| MS                  | Member State  |
| NCA                 | National Competent Authority  |
| PRC                 | Peer Review Committee   |



# 1 Executive Summary

Given the importance of the provision of investment services across the EU under MiFID II<sup>1</sup>, and concerns that emerged in the past on instances of cross-border activities provided in detriment to investors' interests, the Board of Supervisors (BoS) of ESMA decided to launch in 2021 a peer review on National Competent Authorities' (NCAs) supervision of cross-border activities of investment firms. Effective supervision of investment services provided on a cross-border basis is of key importance to ensure that investors in any jurisdiction across the EU are given the adequate level of protection, regardless of the jurisdiction of origin of the entities offering these services.

The peer review was carried out based on the Peer Review Methodology<sup>2</sup> (the Methodology) by an ad hoc Peer Review Committee (PRC).

## *Assessment areas*

The peer review covered the supervision of cross-border activities of investment firms and credit institutions targeting retail clients, under the freedom to provide investment services (FPS) in accordance with Article 34 of MiFID II. Under this framework, the supervision of cross-border activities rests with home<sup>3</sup> NCAs. Accordingly, the peer review focused on the supervision of cross-border activities by home NCAs across seven key areas of the supervision cycle: (i) authorisations; (ii) passport notifications; (iii) arrangements for ongoing supervision; (iv) day to day supervision; (v) investigations and inspections; (vi) exchanges and cooperation with NCAs; and (vii) enforcement / sanctioning. The peer review also covered the work of host<sup>4</sup> NCAs on some areas above, insofar as they can support effective supervision by home NCAs.

Through questionnaires, on-site visits and stakeholders' outreach, the peer review provides an assessment of NCAs against the supervisory expectations on all these key areas as set out in the peer review mandate. While mindful that NCAs may supervise firms in a holistic manner, the peer review focused on NCAs' supervisory work specifically on cross-border activities, so to assess how NCAs deal with risks and challenges related to these activities. Indeed, by deciding to carry out this peer review, and as further defined in the peer review mandate (mandate) forming the basis of this peer review, the BoS set out the expectation that the cross-border activities of firms undergo specific and adequate supervisory focus; such a focus should be calibrated to the risks, specificities and complexities that this type of activities carries for firms, their clients and NCAs' supervision (e.g. in terms of scope of market monitoring, language barriers, information received by host authorities, etc.).

## *Jurisdictions assessed*

The peer review targeted the six most relevant jurisdictions, selected taking into account the significance of their cross-border activities in absolute or relative terms: CZ, CY, DE, LU, MT and NL. The peer review assessed all the six relevant NCAs in their capacity as home NCAs.

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<sup>1</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

<sup>2</sup> [https://www.esma.europa.eu/sites/default/files/library/esma42-111-4966\\_peer\\_review\\_methodology.pdf](https://www.esma.europa.eu/sites/default/files/library/esma42-111-4966_peer_review_methodology.pdf)

<sup>3</sup> home Member State' means the Member State in which the investment firm's head / registered office is situated.

<sup>4</sup> host Member State means the Member State, other than the home Member State, in which an investment firm provides investment services and/or activities.

The assessment of host aspects excluded CY and MT given the limited volume of incoming cross-border activities in these jurisdictions.

The PRC assessed these six jurisdictions against the supervisory expectations identified in the mandate approved by the BoS, taking into account the importance of cross-border activities for the single market of financial services and the key objective of adequately protecting investors across the EU.

### *Overall findings*

While selected on the basis of volume of outgoing cross-border activities by the respective jurisdiction's domestic firms in the EU, still the jurisdictions covered in this peer review vary significantly in terms of nature, scale and complexity of these outgoing cross-border activities, ranging from CY where the predominant model involves investment firms providing cross-border activities to a significant number of retail clients across the EU, often involving high-risk products such as contracts for difference (CFDs), to LU and MT where there is substantial and / or growing outgoing activity, to other jurisdictions such as CZ, DE and NL where investment firms predominantly target the domestic markets with some exceptions of firms being active more substantially cross-border, including in some cases in relation to speculative products.

Accordingly, the PRC applied a proportionate approach considering to what extent NCAs' supervisory work is fit to the nature, scale and complexity of cross-border activities while still taking into account that the selected jurisdictions overall are the most significant ones across the EU in terms of cross-border activities by firms authorised in their jurisdiction.

The peer review reveals a mixed picture of the six NCAs in each of the assessment areas. Overall, home NCAs appear to have established adequate processes in relation to the processing of passport notifications and – with some areas for improvements – in the context of cooperation. At the same time, the PRC identifies that NCAs could significantly improve in their authorisation, supervisory arrangements, day-to-day supervision, investigation and enforcement work in relation to cross-border activities carried out by firms under their supervision. A key element that stands out in this area is that overall home NCAs do not yet sufficiently gather and / or use relevant information as to how firms organise, carry out and control cross-border activities, as to whether, where and to what extent they are active cross-border, and any change thereof. These are key elements to calibrate supervision to the specific features of firms' activities and the actual risk they pose to themselves, to investors and to the financial system as a whole. More in detail, NCAs can be split as follows:

**Home NCAs (all jurisdictions except CY)** - For all jurisdictions, except CY, the PRC identifies - overall and to a different extent among them as further presented in this report - that NCAs do not specifically and structurally consider firms' cross-border activities in their supervision. The PRC appreciates that NCAs conduct supervision holistically looking overall at how the firm organises and conducts its investment activities, regardless of where they are performed. Importantly, this should not lead to a “one-size-fits-all” approach neglecting the specific risks and characteristics of cross-border activities, such as the increased complexity of the firm's organisation due to targeting clients in different jurisdictions with different market characteristics, financial cultures and habits and to tailored business activities (e.g. tailored

products and marketing activities, possibly in different languages). Relatedly, this increased complexity brings additional challenges for the firm's internal control functions (compliance, risk, audit) to oversee, monitor and review the firm's organisation and activities and to mitigate the additional risks to which the firm may be exposed due to its cross-border presence. Likewise, a firm's cross-border activities bring challenges for effective and proactive supervision by the home NCA. By their very nature, cross-border activities risk being carried out beyond a home NCA's usual line of sight, for example because issues are not covered or visible in the home jurisdiction's media or because complaints from foreign investors reach the home NCA only with delay. Cross-border activities bring supervisory challenges for instance in terms of monitoring (or simply checking) communications with clients (e.g. firms' websites, marketing material) in a language other than the domestic language or English, monitoring conduct and performance (e.g. local-market news, external stakeholders' information and complaints) and the increased complexity of the firms' organisation (e.g. different business/marketing strategies).

The PRC identifies that these NCAs, throughout the supervisory cycle:

- are in most cases not sufficiently aware as to whether and to what extent firms are active cross-border and, even when they are, make limited use of the data available for their risk assessment and supervisory planning;
- do not sufficiently identify, assess and monitor the risks related to firms' cross-border activities which have specific characteristics and complexities;
- do not specifically ensure that firms implement adequate controls over these activities;
- have marginal and not specific coverage of cross-border activities through ongoing supervisory work, including when using intrusive supervisory instruments such as investigations or inspections;
- have not developed arrangements to be able to monitor information and documentation on firms' cross-border activities in a language other than their domestic language(s) and English; and
- consider the use of enforcement actions in respect to cross-border activities quite limitedly (in terms of timeliness and / or materiality).

While firms' outgoing activities from these jurisdictions may still be in some cases limited or their supervision facilitated by the NCA's language capacity on some Member States (MS) in which their firms are mostly active, NCAs' supervisory practices should generally step up so to adapt to the growing integration of securities markets and increasing size and complexity of cross-border activities in line with the expectations set by the BoS in the mandate. Indeed, there are indications of a substantial increase in cross-border activities provided by firms, including digital activities, over the past few years offering retail investors across the EU easier access to investing.

While these considerations are generally valid for all these NCAs, differences were observed across NCAs in some specific assessment areas. In assessing each NCA against the supervisory expectations, the PRC also took into account the nature, scale and complexity of outgoing activities.



**Home NCAs (CY)** - While the above-mentioned observations hold valid for CySEC, the PRC notes that of the six MS included in the review sample, CY is the one having the largest portion of outgoing cross-border activities considering (i) the number of firms providing cross-border activities in absolute terms and relative to all authorised firms and to the number of local investors, (ii) the number of firms having a large client base cross-border (with firms often having thousands of clients abroad), and (iii) the share of Cypriot firms' cross-border activities relative to their domestic activities. Moreover, the PRC also observed CySEC reporting by far the highest number of complaints relating to firms' cross-border activities and of requests from other NCAs relating to Cypriot firms' cross-border activities.

In the PRC's view, a very large number of Cypriot firms pose a high risk of investor detriment, due to the frequent provision of services involving speculative products, with aggressive marketing behaviour. While the PRC observed some examples of reasonable and thorough supervisory activities and active use of enforcement measures compared to other NCAs, the PRC concludes that CySEC's supervisory activities have proven overall insufficient at addressing the risks posed by Cypriot firms' cross-border services. The PRC identifies two main causes for this lack of effective outcome, namely an inadequate supervisory approach and insufficient human resources.

As to the former, the overall supervisory approach by CySEC is based on interventions which appear too little and/or too late compared to the overall amount and type of cross-border activities carried out by Cypriot firms and to the concerns raised by them. As a result, the on-going monitoring of firms under CySEC's supervision and the subsequent selection of more intrusive supervisory actions is only able to target firms which have displayed behaviours of significant non-compliance with applicable requirements, in this way setting a quite high threshold in terms of seriousness of the investor protection concerns (and actual harm) before strong supervisory action is taken. Furthermore, when serious shortcomings are identified, sometimes in relation to multiple important MiFID II organisational and conduct requirements, CySEC does not seem to sufficiently identify or assess the root causes of the firm's non-compliant behaviour and does not take or request actions (e.g. remedial actions requested to firms, type of enforcement measure taken) commensurate to the nature and scale of risks, problems and shortcomings identified, so to effectively prevent them or bring them to an end. In other words, CySEC maintains a fragmented approach to individual problems, generally only acting once they have materialised, whereby even for firms exhibiting aggressive behaviour involving serious or recurring infringements, CySEC often requests isolated and narrow remediation (e.g. revised ad-hoc policies and procedures) or takes overall limited enforcement measures (e.g. a few-week suspension of activities or recurring settlement). In the PRC's view, CySEC should take a comprehensive, and more timely, approach in such cases, assessing and where necessary putting into question whether such firms are really able to ensure sustainable compliant behaviour, and applying sufficiently strong measures to achieve this. In light of this, the PRC recommends CySEC to adopt a supervisory approach (including enforcement) which aims at ensuring sustainable compliant behaviour by firms.

The PRC considers that the other main cause explaining CySEC's shortcomings is the severe shortage of human resources. While CySEC was responsible for supervising 239 firms in 2020, the large majority of which provide cross-border activities, it has a total of 13 FTEs in charge

of ongoing supervision<sup>5</sup>. Out of these FTEs, eight are responsible for ongoing and thematic supervision, and five for investigations / enforcement. An officer in charge of ongoing supervision is responsible for the monitoring of 30 high and medium-high risk firms, as classified by CySEC, on average. The PRC considers CySEC not to be equipped to cope with supervising the substantial and risky cross-border sector, as also evidenced by the high number of client complaints and requests from other NCAs received. The PRC therefore recommends CySEC to significantly increase the supervisory resources devoted to the supervision of firms' cross border provision of services.

The PRC also notes that, in light of CySEC's shortcomings in the supervisory area, a qualitative and probative scrutiny on firms' cross-border plans at authorisation stage is rendered even more essential. However, also in this area, the PRC considers CySEC's approach as insufficient, especially given the volume of cross-border activities carried out by Cypriot firms and the observed shortcomings in the way firms eventually carried out such activities.

**Host NCAs** - Under MiFID II, the supervision of firms active cross-border through FPS rests with the relevant home NCA. Nevertheless, host NCAs can play an important role to support effective supervision by home NCAs by providing targeted input, intelligence and evidence on activities carried out in their territory, when possible. The PRC overall found that the four host NCAs covered in this peer review perform satisfactorily in this regard and made a positive assessment of NCAs' work as host. At the same time, cooperation is often discharged through written exchanges and limited to complaint-specific situations. The PRC suggests that NCAs could improve cooperation with each other by engaging in more regular exchanges of intelligence, evidence and views, scouting opportunities for supervisory discussions at different levels of seniority, expertise and formality.

**Overall assessment** - The tables below summarise the PRC's assessment of NCAs, in their role as home and host (as applicable) in each assessment area based on the benchmarks in the Methodology. It should be emphasised that this assessment concerns the specific approach for the supervision of firms' cross-border activities and not the general supervision of investment firms and credit institutions providing investment services and activities.

**TABLE 1 - ASSESSMENT OF NCAS IN HOME CAPACITY**

|   | AFM | BaFin                     | CNB | CSSF | CySEC | MFSA |
|---|-----|---------------------------|-----|------|-------|------|
| <b>Authorisation activities</b>             |     |                           |     |      |       |      |
| <b>Processing of passport notifications</b> |     |                           |     |      |       |      |
| <b>Arrangements for ongoing supervision</b> |     |                           |     |      |       |      |
| <b>Day to day supervision</b>               |     |                           |     |      |       |      |
| <b>Investigations and inspections</b>       |     |                           |     |      |       |      |
| <b>Cooperation and exchanges with NCAs</b>  |     |                           |     |      |       |      |
| <b>Enforcement and sanctioning</b>          |     | Not assessed <sup>6</sup> |     |      |       |      |

<sup>5</sup> Excluding support staff and supervisory staff dealing with the processing of authorisations and passport notifications.

<sup>6</sup> These NCAs could not be assessed on their use of enforcement on cross-border activities as they indicated that they did not identify any infringement in the review period clearly in relation to such activities. Similarly, CSSF could not be assessed in respect to some expectations in their role as host authority due to the lack of relevant examples / experience in the review period.

**TABLE 2 - ASSESSMENT OF NCAS IN HOST CAPACITY**

|   | AFM | BaFin | CNB | CSSF                      |
|---|-----|-------|-----|---------------------------|
| <b>Processing of passport notifications</b> |     |       |     | Not assessed <sup>6</sup> |
| <b>Cooperation and exchanges with NCAs</b>  |     |       |     |                           |
| <b>Enforcement and sanctioning</b>          |     |       |     | Not assessed <sup>6</sup> |

|                            |                              |                                |                          |
|----------------------------|------------------------------|--------------------------------|--------------------------|
| Fully meeting expectations | Largely meeting expectations | Partially meeting expectations | Not meeting expectations |
|----------------------------|------------------------------|--------------------------------|--------------------------|

*Recommendations*

**Supervisory recommendations:** NCAs should scale up their approach so that the specific risks arising from firms’ cross-border activities are adequately identified, assessed, addressed and prioritised when needed, similarly to the tailoring of supervision to other risks arising from firms’ domestic activities. This includes, for instance, to (i) introduce targeted criteria and controls in the authorisation process to assess information in relation to firms’ intentions to perform cross-border activities; (ii) collect related data on a regular basis, feeding them in the risk / supervisory model; (iii) carry out close monitoring of cross-border activities and use supervisory tools according to the risks identified. With regard to CySEC, in view of the shortcomings observed, two recommendations are made under Article 16 of ESMAR and will be followed up accordingly.

**Short and long-term cross-cutting recommendations:** the PRC suggests considering supervisory convergence initiatives to facilitate NCAs’ access to and exchange of information including through data collection on actual cross-border activities (e.g. by continuing running the data collection exercise on cross-border activities coordinated by the ESMA’s Investor Protection and Intermediaries Standing Committee (IPISC) in 2020) and improving NCAs’ assessment and understanding of cross-border related risks (e.g. through discussion among senior supervisors on NCA’s risk-based approaches to supervision). In this context, practical arrangements among home / host NCAs (such as for examples through delegation of tasks) may also be explored. The PRC notes the importance that NCAs effectively communicate to make use of information available to each other, and notes that supervisory convergence initiatives to facilitate sharing information on fitness and propriety assessment of individuals and secure exchange of information, are also under way.

*Good practices*

Some good practices were also identified in the peer review, such as: (i) the use of supervisory tools to monitor firms’ social media activities; (ii) data collection on firms’ cross-border activities on a quarterly basis; and (iii) to proactively scout opportunities to exchange views and intelligence on incoming / outgoing cross-border activities of firms with other NCAs.

While the peer review covers six NCAs, all NCAs in the EU could consider the findings, recommendations and good practices in this report in the context of their supervisory framework. Indeed, to a varying extent, all NCAs across the EU have a responsibility as home authority to supervise outgoing cross-border activities from firms authorised in their jurisdictions. In turn, all NCAs will also be impacted, from a host perspective, if investment



services provided to retail clients in their territory under FPS are detrimental to clients' interests; several jurisdictions in the EU experienced such cases. Therefore, all NCAs across the EU have a role to play and can benefit from each other's reinforced supervisory practices for supervision of cross-border activities of investment firms in the context of the single market for investment services.

## **2 Introduction**

1. This report presents the main findings of the peer review carried out on NCAs' supervision of cross-border activities of investment firms.
2. The report is organised as follows: (i) this section provides background information on the peer review work; (ii) Section 3 provides contextual information on the nature, scale and complexity of cross-border activities outgoing from the jurisdictions in scope and relevant supervisory organisation; (iii) Section 4 presents the peer review findings and assessment including recommendations and good practices; (iv) the Annexes enclose the mandate that formed the basis of the peer review, the questionnaire sent to NCAs in scope, and the statement provided by CySEC.

### **2.1 Background**

3. MiFID II and its implementing measures were adopted to offer a higher level of protection to investors and ensure the uniform application of the requirements in the EU. In this context, MiFID II recognises the importance to allow the provision of investment services across the EU. This is a key element of the single market of financial services as it fosters competition and expands the offer available to consumers who can choose among a broader number of financial institutions and investment opportunities.
4. Effective supervision by NCAs of entities providing investment services on a cross-border basis is therefore of key importance to ensure that clients, especially retail, are given the adequate level of protection regardless of the jurisdiction of origin of the entities offering these services.
5. Several jurisdictions in the EU experienced cases where investment services were provided to clients in their territory under the freedom to provide services framework with prejudice to the interest of retail investors in the host jurisdictions.
6. In view of the above, the BoS decided in 2020, through the ESMA Annual Work Programme 2021, to launch a peer review on NCAs' supervision of cross-border activities of investment firms. In January 2021, the BoS approved the mandate for this peer review (enclosed in Annex 1), to be conducted in accordance with Article 30 of ESMAR and the Methodology.

### **2.2 Scope of the peer review**

7. The peer review focuses on supervision of cross-border activities of investment firms and credit institutions targeting retail clients, under the FPS framework.

8. In particular the review considers seven assessment areas<sup>7</sup> as relevant to supervision:
- a. Authorisation pursuant to Articles 5, 6 and 7 of MiFID II<sup>8</sup>;
  - b. Processing of passport notification pursuant to Article 34 of MiFID II<sup>9</sup> and their impact on the supervisory approach applied to firms;
  - c. Arrangements in place to carry out ongoing supervisory activities;
  - d. Carrying out of day to day supervision;
  - e. Carrying out of investigations and inspections;
  - f. Exchanges and cooperation between home and host NCAs in the context of ongoing supervisory activities insofar as it is necessary to ensure effective supervision of cross-border services by home NCAs; and
  - g. Enforcement activities in relation to home NCAs considering or applying administrative sanctions and measures imposed pursuant to Article 70 of MiFID II, and host NCAs precautionary measures pursuant to Article 86 of MiFID II.
9. The PRC worked across these areas primarily in relation to NCAs' work in their home authority capacity. This is because under the FPS framework, supervisory responsibility of cross-border activities rests with home authorities. In addition, the PRC considered in some areas the work of host NCAs in supporting effective supervision by the home authorities.
10. Across these areas, and in accordance with ESMAR, the PRC reviewed the independence of the NCAs and their capacity to achieve high quality supervisory outcomes, including the adequacy of resources and governance and the effective application of MiFID II, the capacity of the NCA to respond to market developments, the degree of convergence in the application of law and supervisory practices, and the extent to which the practices achieve MiFID II objectives.

## 2.3 NCAs under review

11. The peer review targeted the six most relevant jurisdictions,<sup>10</sup> namely those with the highest volume of outgoing cross-border activities across the EU in absolute or relative terms.<sup>11</sup>

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<sup>7</sup> While there is not a strong demarcation between the areas (i) arrangements in place to carry out ongoing supervisory activities, (ii) carrying out of day to day supervision and (iii) carrying out of investigations and inspections, the mandate considers these elements separately in the interest of providing a clearer representation on which supervisory activities may be more challenging and the reasons why. Under this split and in summarised terms, these three areas look at the following aspects: area (i) looks at the established supervisory framework in terms of policies and procedures, data collection and risk assessments; area (ii) looks at how NCAs apply in practice this framework in terms of regular supervisory activities encompassing monitoring information and complaints, regular engagement with firms and other desk-based activities; area (iii) looks at whether and how NCAs make also use of more intrusive tools such as onsite inspections to further examine certain activities, when so required by the risks identified.

<sup>8</sup> Only in respect of investment firms.

<sup>9</sup> Only in respect of investment firms.

<sup>10</sup> Under the Peer Review Methodology, peer reviews can cover all EEA NCAs or restricted to a limited number of NCAs and/or target a limited scope of activities of certain NCAs.

<sup>11</sup> The selection of these NCAs was based on the following objective criteria: (i) the number of investment firms and credit institutions registered in a given Member State and holding a passport to provide services across EEA6, in absolute terms and relative to the size of the jurisdiction; and (ii) balanced geographical distribution. Based on the data available at the start of the peer review work, the volume of cross-border activities was considered in terms of the number of firms authorised in these jurisdictions holding a passport to provide services cross-border.

These are listed in Table 3. The peer review assessed all six NCAs in their capacity as home authorities. In addition, the peer review assessed NCAs in CZ, DE, LU, NL in relation to a limited number of aspects as regards their role as host authorities. NCAs in CY and MT were excluded from the assessment of host aspects, given the limited incoming cross-border activity in their jurisdictions.

**TABLE 3 - NCAS ASSESSED IN THE PEER REVIEW**

| Code | Country        | Competent Authority                             | Acronym | Assessment  |
|------|----------------|---|---------|-------------|
| CY   | Cyprus         | Cyprus Securities and Exchanges Commission      | CySEC   | Home only   |
| CZ   | Czech Republic | Czech National Bank                             | CNB     | Home / Host |
| DE   | Germany        | Bundesanstalt für Finanzdienstleistungsaufsicht | BaFin   | Home / Host |
| LU   | Luxembourg     | Commission de Surveillance du Secteur Financier | CSSF    | Home / Host |
| MT   | Malta          | Malta Financial Services Authority              | MFSA    | Home only   |
| NL   | Netherlands    | Autoriteit Financiële Markten                   | AFM     | Home / Host |

## 2.4 Process of the Peer review

12. The peer review was carried out by the ad hoc PRC identified in the mandate and composed of experts from NCAs and from ESMA staff and chaired by a senior ESMA staff member.
13. As a basis of the assessment, in February 2021 the PRC addressed a questionnaire (enclosed in Annex 2) to the NCAs in scope, followed by complementary information and documentation requests between April and July 2021. On-site visits<sup>12</sup> took place to the six NCAs between 8 June and 13 July 2021. Such on-site visits to NCAs, including the related access to representative samples of supervisory files and cases, played a key role in enhancing the understanding of the NCAs' supervisory approaches and to assess the NCAs against the supervisory expectations defined in the mandate. The PRC wishes to note that visited NCAs engaged openly and constructively and to thank NCAs for the good cooperation in this peer review.
14. During these visits, the PRC met with stakeholders in each country visited, as facilitated by each NCA. In total the PRC met seven stakeholders, including one EU-wide investors association, so to further capture relevant cross-border perspectives. The outcome of discussions with stakeholders was taken into account in the assessment in Section 4.
15. The period under review covers 1 September 2018 to 31 August 2020.
16. The PRC reported its findings to the BoS, for its approval, after having consulted the Investor Protection and Intermediaries Standing Committee (IPISC), as the relevant Standing Committee for the topics at stake, and the Management Board (MB).
17. For each of the seven assessment areas, the mandate identifies supervisory expectations against which NCAs have been assessed. Considering these expectations, the PRC made

<sup>12</sup> Conducted through remote settings, due to sanitary conditions and travel restrictions linked to Covid-19.

a qualitative assessment whether for each of the seven assessment areas, an NCA is likely to be: (i) fully meeting the peer review’s expectations, (ii) largely meeting the peer review’s expectations, (iii) partially meeting the peer review’s expectations or (iv) not meeting the peer review’s expectations. The summary of findings and assessment for each of the seven assessment areas is included in Section 4.1. The assessment table for all NCAs and the areas for improvement identified are set out in Section 4.2. Good practices identified in each assessment area are presented in Section 4.3.

### 3 General information

18. This section sets out background information on the volume of cross-border activities outgoing from the jurisdictions in scope. As it is shown, the outgoing cross-border activity supervised by the six NCAs under review varies importantly in nature and size. The PRC indeed recognises that the level of supervision carried out on firms’ cross-border activities should be proportionate to their nature, scale and complexity. Therefore, when assessing each NCA against the supervisory expectations set out in the mandate, the PRC considered the overall volume, type and complexity of outgoing cross-border activities and the risks attached.

19. Table 4 provides an overview, for each NCA on: (i) the total number of investment firms and credit institutions supervised; (ii) the total number of firms holding a passport; (iii) the total number of firms actually active cross-border, where the NCA has this information.<sup>13</sup>

**TABLE 4 – FIRMS ACTIVE CROSS-BORDER<sup>14</sup>**

| <b>Investment firms</b>   | <b>AFM</b>          | <b>BaFin</b> | <b>CNB</b> | <b>CSSF</b> | <b>CySEC</b> | <b>MFSA</b> |
|---|---------------------|--------------|------------|-------------|--------------|-------------|
| <b>Total n. of investment firms supervised under MiFID II</b>   | 228                 | 733          | 22         | 92          | 239          | 68          |
| <b>Total n. of investment firms supervised under MiFID II that <u>provided the NCA with a passport notification</u></b> | 167                 | 323          | 14         | 84          | 230          | 44          |
| <b>Total n. of investment firms that <u>actually provide services on a cross-border basis</u></b>                       | not available (n/a) | 203          | 10         | 52          | 164          | 26          |

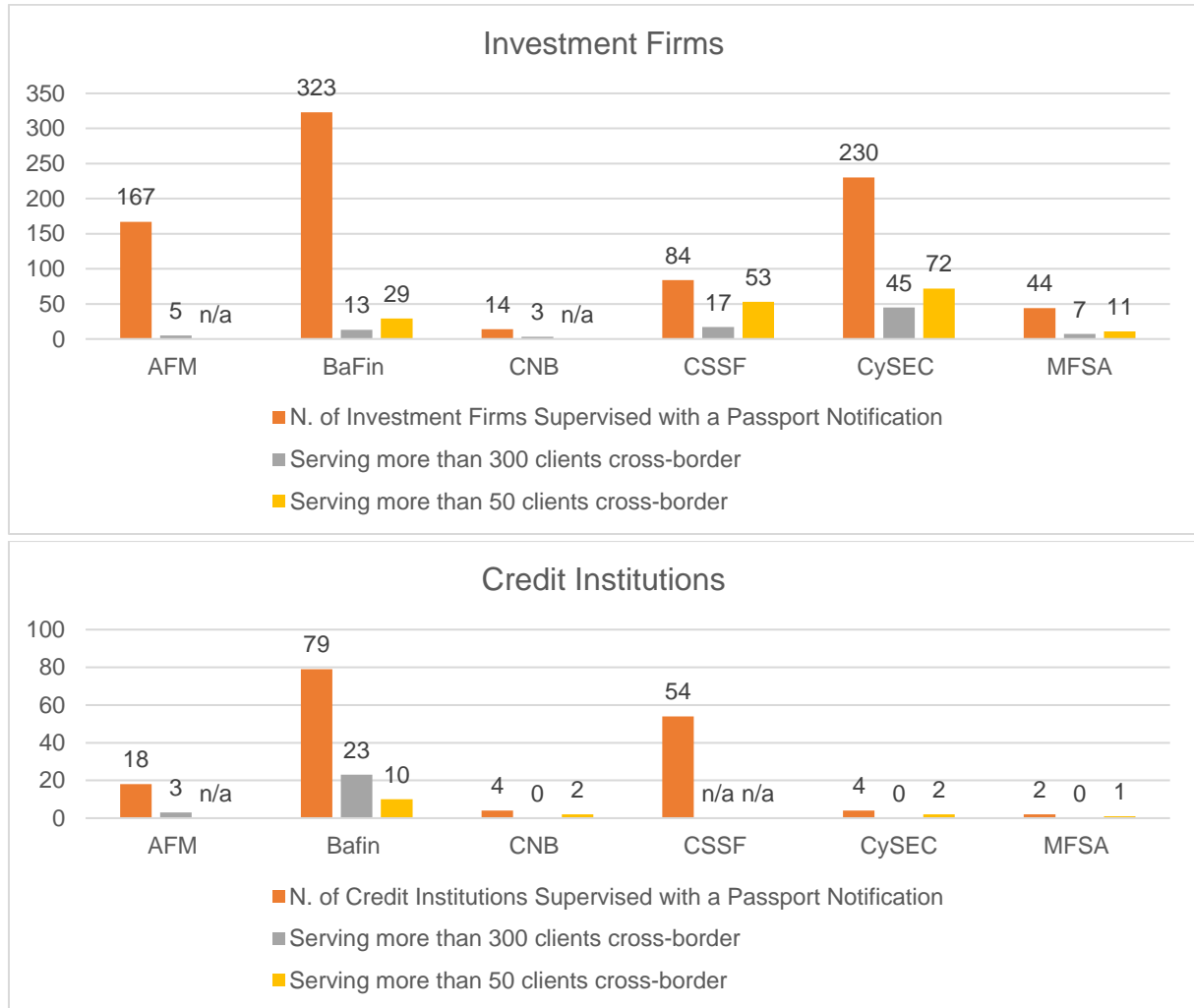
| <b>Credit institutions</b>   | <b>AFM</b> | <b>BaFin</b> | <b>CNB</b> | <b>CSSF</b> | <b>CySEC</b> | <b>MFSA</b> |
|--|------------|--------------|------------|-------------|--------------|-------------|
| <b>Total n. of credit institutions supervised under MiFID II</b>   | 19         | 1321         | 16         | 127         | 7            | 9           |
| <b>Total n. of credit institutions supervised under MiFID II that <u>provided the NCA with a passport notification</u></b> | 18         | 79           | 4          | 54          | 4            | 2           |
| <b>Total n. of credit institutions that <u>actually provide services on a cross-border basis</u></b>                       | n/a        | 44           | 2          | n/a         | 3            | 1           |

<sup>13</sup> As further explained in the report: (i) BaFIN collected these data for the purpose of answering the PRC questionnaire, as they do not systematically collect these figures (ii) for other NCAs marked as n/a, the NCA does not have the relevant information.

<sup>14</sup> These tables are meant to show the relative portion of firms having a passport and being active cross-border, out of those authorised within each jurisdiction, and not to compare the number of cross-border-active firms from each jurisdiction, which is different in scale across the six NCAs as can be observed through the numbers indicated in the graphs.

20. Beyond the number of firms holding a passport and actually providing cross-border services, Table 5 provides an indication of the volume of cross-border activities in terms of firms serving more than 300 or 50 clients in other MS, where the NCA has this information.

**TABLE 5 – VOLUME OF CROSS-BORDER ACTIVITIES<sup>15</sup>**



21. Finally, Table 6 provides an indication of the top 3 MS where firms providing cross-border activities are actually active, distinguishing between investment firms and credit institutions, where available to the NCA.

**TABLE 6 – TOP 3 MS IN WHICH FIRMS PROVIDING CROSS BORDER ACTIVITIES ARE ACTIVE**

| NCAs       | For Investment Firms | For Credit Institutions |
|------------|----------------------|-------------------------|
| <b>AFM</b> | BE, FR, DE           | BE, FR, DE              |

<sup>15</sup> AFM collected information (through the IPISC cross-border exercise described in paragraph [30]) on the total number of firms having more than 300 clients cross-border, but not on firms having more than 50 clients cross-border, nor on the total number of firms being actually active cross-border. BaFin collected the data for the purposes of answering to the peer review questionnaire as they do not systematically collect these figures. n/a in this graph means “not available” as further explained in the report. At the time this report is being drafted, AFM indicated that they have in the meantime collect information on firms having more than 50 clients in other MS, which amounts to 3 investment firms and 0 credit institutions. For CSSF, no data are collected on actual cross-border activity by credit institutions.



|              |               |                  |
|--------------|---------------|------------------|
| <b>BaFin</b> | LU, AT, LI&NL | FR, AT, LU       |
| <b>CNB</b>   | SK, HU, BG    | AT, PT, SK       |
| <b>CSSF</b>  | DE, FR, BE    | Not available    |
| <b>CySEC</b> | DE, IT, ES    | EL, DE, BG       |
| <b>MFSA</b>  | DE, IT, ES    | IE <sup>16</sup> |

22. A number of considerations can be drawn from the above tables. First of all, with the partial exception of CSSF, investment firms are significantly more active<sup>17</sup> cross-border than credit institutions. Given that the portion of credit institutions active cross-border from MT and CY is very limited, the peer review on MFSA and CySEC focused its assessment on the supervisory activities carried out on investment firms only.<sup>18</sup>
23. Looking solely at the number of investment firms holding a passport out of the total number of authorised investment firms in each jurisdiction (Table 4), NCAs can be ranked as follows, from those having the highest portion of supervised firms holding a passport to the lowest: CySEC (96%), CSSF (91%), AFM (73%), MFSA (65%), CNB (64%), BaFin (44%). Looking at credit institutions, the order is: AFM (65%), CySEC (57%), CSSF (43%) CNB (25%), MFSA (22%), BaFin (6%). However, as indicated above, these numbers should be considered in light of the overall fewer credit institutions active cross-border as compared to investment firms.
24. Only some NCAs have complete and up to date information on the firms holding a passport and that are actually active cross-border. In particular, AFM (except on firms having more than 300 clients in other MS), BaFin and CSSF (for credit institutions only) did not regularly collect up to date data on firms' actual cross-border activities in the review period. For most NCAs, the data available were not structurally collected and integrated into daily supervisory activity, but collected primarily in the context of a pilot exercise on cross-border activities coordinated by the ESMA's Investor Protection and Intermediaries Standing Committee (IPISC) in 2020 (thereafter, the IPISC cross-border exercise).<sup>19</sup>
25. Based on the above figures, almost 70% of the investment firms authorised by CySEC is active cross-border, 57% for CSSF, 45% for CNB, 38% for MFSA, and 28% for BaFin. For credit institutions, 43% of those authorised in CY are active cross-border, 12% for CZ, 11% for MT and 3% for DE. As already mentioned, this should be read having in mind the limited number of credit institutions authorised in MT and CY and having a passport.
26. Supervisory risks and complexities differ depending on the firms' client base in other jurisdictions.<sup>20</sup> Taking as reference the number of firms having notified home NCAs with a passport notification, it is noted (Table 5) that, in CY, LU, MT and CZ around 20% of investment firms (respectively, 45, 17, 7 and 3) have more than 300 clients abroad. In NL and DE the figure decreases to respectively 3% and 4%, although this figure should be read having in mind that both jurisdiction have a large number of very small firms that are

<sup>16</sup> This is the only EU MS where the credit institution active cross-border provides services outside MT.

<sup>17</sup> At least in terms of number of firms being active in other MS.

<sup>18</sup> CySEC and MFSA should nevertheless take into account the observations raised in this peer review in relation to their investment firms for the supervision of credit institutions' cross-border activities, performed by them and / or by other competent authorities (e.g. central banks) in their jurisdictions.

<sup>19</sup> In the case of BaFin, data shown above for the purpose of answering the peer review questionnaire.

<sup>20</sup> E.g. firms actively marketing their services to a large number of cross-border clients; firms only having a handful of clients in other jurisdictions; firms mostly serving clients residing abroad but originating from the MS where they are authorised.

active only locally and not cross-border. Looking at credit institutions, only credit institutions authorised in DE and NL have more than 300 clients in other EU MS (29% and 17%, respectively). In LU, the information is not available for credit institutions. Looking at the threshold of more than 50 clients in other MS, 63% of the investment firms in LU, 31% in CY, 25% in MT and 8% in DE exceed this threshold. For CZ, the information is not available for the review period. As to credit institutions holding a passport, 50% of those authorised in CY and MT, 25% in CZ and 13% in DE exceed the threshold of 50 clients in other MS. AFM could not provide this information for both types of firms, CSSF could not provide it for credit institutions only.

27. Cross-border activities carried out in foreign languages require different supervisory arrangements (e.g. translation arrangements, ability to monitor news and marketing material on an ongoing and proactive basis, etc.) compared to activities carried out in a language ordinarily spoken by the NCA's staff (or a language which is an official language in the home MS).<sup>21</sup> Based on the information available, for CZ, a large portion of outgoing cross-border activities is carried out in SK in relation to which CNB has language capacity.<sup>22</sup> To some extent, some cross-border activities outgoing from DE<sup>23</sup> and LU<sup>24</sup> are also carried out in jurisdictions on which the relevant NCAs have language capacity.
28. Overall, data available to the PRC<sup>25</sup> show that, while selected on the basis of volume of outgoing activities by domestic firms in the EU, still the jurisdictions covered in this peer review vary significantly in terms of nature, scale and complexity of these outgoing cross-border activities. Notably, the outgoing cross-border activity supervised by CySEC is very significant compared to its peers. Indeed, of the six jurisdictions covered by this peer review, CY is the one having the largest portion of outgoing cross-border activities considering (i) the number of firms providing cross-border activities in absolute terms and relative to all Cypriot firms and to the number of local investors, (ii) the number of firms having a large client base cross-border (i.e. having more than 300 or 50 clients abroad), and (iii) relative share of Cypriot firms' cross-border activities relative to their domestic activities. For LU several firms supervised by CSSF are active cross-border, including with a large client base. For MT the volume of outgoing cross-border activities by supervised firms is lower compared to CY but it is growing as indicated in Section 4.1.1 on authorisations; similarly to CY, the firms active cross-border from MT mostly target foreign rather than domestic clients. For NL, CZ and DE, firms are mostly active in domestic markets, with some firms active cross-border, only some of which on a large scale. For CZ, the highest volume of cross-border activities is in Slovakia (on which the authority has language capacity). Nevertheless, also for these three jurisdictions, the outgoing cross-border activities is not negligible, either in relative (over 60% of firms in CZ and NL have a passport) or in absolute terms (402 firms in DE have a passport to provide services across the EU).

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<sup>21</sup> In addition to this, the PRC notes that some NCAs may also benefit from staff speaking additional language other than the official languages in the home MS, although none of the NCAs explained and evidenced clearly that these are structurally used in their supervisory work in relation to cross-border activities (e.g. in proactively monitoring websites and marketing material, etc.).

<sup>22</sup> Besides the information in Table 6, granular data provided by CNB indicate that around 5% of clients from cross-border activities are from nationalities other than Czech and Slovak.

<sup>23</sup> At least with respect to some of the official languages in some MS listed in Table 6.

<sup>24</sup> Although these may not present the majority of such activities. CSSF indicated that the total part of revenues stemming from France, Germany and Belgium represent 29,48% of the total annual revenues of the investment firms (Belgium: 2,97%, France: 4,37%, Germany: 22,14%). Additional data to put this figure into context could not be provided by CSSF.

<sup>25</sup> Data from the above tables as complemented by additional colour gathered through the on-site visits and further detailed in Section 4 of this report and in the country reports.

## 4 Peer review findings

29. The following sections contain a summary of the peer review findings as follows: (i) the assessment of the seven assessment areas and a summary of the on-site visits (Section 4.1); (ii) the assessment table and the PRC recommendations (Section 4.2); (iii) the good practices that the PRC identified (Section 4.3).

### 4.1 Peer review findings in each area under review

30. The peer review assessed NCAs in each area against specific supervisory expectations detailed in the peer review mandate.<sup>26</sup> As mentioned in Section 3, all NCAs were assessed in relation to cross-border supervision of both investment firms and credit institutions<sup>27</sup>, except CySEC and MFSA which were assessed only with regard to investment firms given that only very few credit institutions are active cross-border and for a very small number of clients.
31. The supervisory expectations set out in the mandate are summarised below in the introduction of each assessment area. These expectations take into account that there are specific risks and characteristics arising from firms' cross-border activities that need to be reflected in the way supervision is carried out at all stages, including: (i) increased complexity of the firm's organisation due to targeting clients in different jurisdictions with different market characteristics, financial culture and habits and to tailored business activities (e.g. tailored products and marketing activities, possibly in different languages); (ii) additional challenges for the firms' internal control functions (compliance, risk, audit) to oversee, monitor and review the firm's organisation and activities and to mitigate the additional risks to which the firm may be exposed due to its cross-border presence; (iii) corresponding challenges for effective and proactive supervision by the home NCA, for example because of the difficulties in monitoring (or simply checking) communications with clients (e.g. firms' websites, marketing material) in a language other than the domestic language or English, as well as in monitoring conduct and performance (e.g. local-market news, external stakeholders' information and complaints) and the increased complexity of the firms' organisation (e.g. different business/marketing strategies); and (iv) the need to exchange information and intelligence so to increase visibility on firms' activities and investors' experience, which requires cooperation to work effectively.
32. In considering the specificities of cross-border activities, the mandate (and the PRC) recognises that NCAs may carry out supervision holistically, considering the entire organisation, activities and services provided by a firm, without systematically singling out the cross-border component. At the same time, the mandate notes that cross-border activities entail specificities and risks that should be clearly recognised and addressed by NCAs' supervision based on the nature, scale and complexity of such cross-border activities. Accordingly, the mandate sets expectations that supervisors clearly understand, monitor and reflect on the cross-border dimension of firms in their work and that they are able to demonstrate the relevant work that they conduct on firms' cross-border activities. In other words, the holistic approach should not be seen as a one-size-fits-all approach

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<sup>26</sup> A summary of supervisory expectations is provided in each sub-section below. For the detailed supervisory expectations in each assessment area, please refer to the mandate enclosed in Annex 1.

<sup>27</sup> Except for the authorisations and passport notification sections which were relevant only for investment firms.

whereby, for example, a firm active only locally and a firm that markets services across several MS in different languages, other things equal, would require the same type of scrutiny. The calibration of supervision to the specific features of firms' activities and the actual risk they pose to themselves, to investors and to the financial system as a whole is a known approach by NCAs; taking firms' cross-border activities into account in this calibration is therefore a necessary dimension of this approach.<sup>28</sup>

#### 4.1.1 Authorisation activities

33. The PRC considered how home NCAs grant authorisations under Articles 5, 6 and 7 of MiFID II in respect of firms that at the authorisation stage foresee undertaking cross-border activities, and how home NCAs ensure that the objectives set out by MiFID II are met. The PRC assessed whether home NCAs: (i) have a demonstrable supervisory approach to consider investment firms' plans for cross-border activities at authorisation stage; (ii) ensure thorough critical scrutiny of authorisation in this respect; and (iii) use in authorisations intelligence collected through cooperation with / requests from host NCAs.

34. In this sub-section, the term "firms" refers only to investment firms.

#### Summary of findings

35. Applicant firms with cross-border plans at authorisation stage: Four out of the six NCAs in scope [BaFin, AFM, MFSA and CySEC] reported that the majority of applicant firms in their jurisdiction over the review period indicated having cross-border plans.<sup>29</sup> For two of them [CySEC and MFSA], this was in fact the case for the totality of applicant firms. For the remaining two NCAs [CSSF and CNB], only a minority (respectively a third and approximately 11%) indicated that they had plans to provide services on a cross-border basis. With respect to MFSA, the PRC also notes that the number of applications for authorisation received relative to the total number of firms supervised in the review period is particularly high compared to peers (42%, compared to an average of 12%), which may signal a growing interest from firms intending to provide cross-border services to be active in MT.

36. Applications rejected: Only one NCA [CySEC] indicated that they rejected applications during the review period (five applications). One NCA [BaFin] however indicated that the fact that they had not formally rejected applications could be explained by applicant firms usually preferring to withdraw an application when the NCA signal to them that a rejection is likely. Another NCA [CSSF] explained that applicant firms were also withdrawing their applications if they judged that the authorisation requirements were too strict or cumbersome or found the time necessary to obtain their authorisation too long. For this NCA, five withdrawals occurred during the review period.

37. Policies and procedures in relation to the authorisation of firms with cross-border plans: three NCAs [AFM, CNB and CSSF] confirmed that they do not have any cross-border

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<sup>28</sup> For example (i) in the authorisation stage, assessing whether a firm's organisation is fit for purpose, by considering the characteristics and risks of planned cross-border activities planned and the related organisation of internal control functions' monitoring and review activities; (ii) in ongoing supervision, collecting basic data on firms' cross-border activities to have a basic view of the extent, characteristics and risks of such activities and subsequently plan monitoring activities; (iii) considering in investigations high-risk cross-border activities, or assessing relevant samples of cross-border clients, etc.

<sup>29</sup> BaFin noted that this was exceptional due to Brexit-related relocation of firms and that in general only a portion of firms indicating cross-border activities plans actually engages in such activities.

specific policies, procedures or guidance (together, P&P). Out of the other three NCAs that indicated having such specific cross-border P&P [BaFin, CySEC and MFSA], only two [MFSA and CySEC] could actually demonstrate them as they have specific checks requiring applicant firms to provide cross-border specific information<sup>30</sup> to build upon the information required under Article 6(a), 6(c), 6(g) and 6(l) of Commission Delegated Regulation (EU) 2017/1943 (regulatory technical standards on information and requirements for the authorisation of investment firms). Further to detailing information to be provided by applicant firms, MFSA's P&P lists a number of controls to assess a firm's adequacy to operate cross-border.<sup>31</sup> These P&P do not include specific controls in relation to the foreign languages in which cross-border activity may be carried out, and in particular whether internal control functions have capacity and processes to oversee the information provided to clients in local languages.<sup>32</sup> The cross-border specific information required by CySEC in its P&P focuses on the cross-border distribution of the firm's products and services (how the firm intends to market and distribute its products and services). The other NCA [BaFin] could not show cross-border P&P further specifying the information required under Article 6 of Regulation 2017/1943 and/or providing staff with a demonstrable guidance on how to assess the information required under Article 6(a) and the corresponding firms' internal controls and procedures.

38. Supervisory approach to the authorisation of firms with cross-border plans: all NCAs indicated that they approach the authorisation process of applicant firms holistically. Therefore, they indicated not differentiating between applicant firms that intend to provide cross-border services and those that intend to provide services solely in the home MS because the cross-border dimension of the business of the firm would be sufficiently addressed through their general P&P relating to the authorisation of investment firms. Two NCAs [MFSA and CySEC] however tackle firms' cross-border activities specifically through the obligation for applicant firms to provide additional information relating to their cross-border business and some specific controls, as indicated above. For MFSA however, based on the evidence provided to the PRC, the PRC considers that these additional controls, although positive, would benefit from more thorough scrutiny by MFSA staff. CySEC, on the other hand, could not demonstrate to the PRC that the additional information relating to cross-border activities and listed in its P&P was systematically required and how it was assessed.<sup>33</sup> For the other NCAs [BaFin, CSSF, CNB, AFM,], the PRC could not identify how the firm's policies and procedures, organisational

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<sup>30</sup> For MFSA, it includes the firm's arrangements and organisation with regard to the cross-border activities to be undertaken, the support structures available to the compliance officer of the firm to mitigate the additional risks to which the firm may be exposed due to its cross-border activities, whether the firm will be outsourcing any part of its activities in any host MS, etc. For CySEC, it includes information on: (i) whether introducing brokers will be used for the provision of services in third countries, (ii) the control mechanisms for *tyed agents and introducing brokers*, (iii) the firm's advertising campaign in host Member States, (iv) the network used for commercialisation of the firm's products in host Member States (e.g. unlicensed company in the host Member State, tied agent in the host Member State without notification) and (v) how the firm intends to promote its services in Member States in which the retail distribution is banned

<sup>31</sup> e.g. controls on the envisaged arrangements and organisation of the investment firm with regards to the cross-border activity to be undertaken, and the support structure available to the Compliance Officer to mitigate additional risks linked to cross-border activities

<sup>32</sup> These controls are formally indicated in MFSA's passporting P&Ps. For applicant firms with cross-border plans, the PRC noted that the assessment of the applicant is a two-step process: first the more general assessment of the firm is done and the licence granted (as the case may be) and, in a second time but before the firms starts providing services on a cross-border basis, the MFSA goes through the necessary passporting notifications and performs such substantial and cross-border specific checks.

<sup>33</sup> These controls are included in CysEC's "Activation Control Program" which is a document covering a pre-authorisation on-site inspection. However, this document was provided at a late stage to the peer review (24 November 2021 after previous several exchanges of information and documents, the remote on-site visit and the accuracy check carried out by CySEC) and it was therefore not discussed during the on-site visit. The peer review did not see evidence that it was systematically used and how (including during the on-site visit).

arrangements (including internal controls), business plans, resources, marketing strategy and material were assessed in relation to cross-border activities, in cases in which the applicant firm has expressed the intention to provide these activities. One of these NCAs [CSSF] could however demonstrate during the on-site visit that, where an applicant firm intends to use tied agents for its marketing activities, they check the adequacy of the reporting lines between such tied agent(s) and the applicant firm.

39. For CySEC, in addition to the above, the PRC could see that a restriction on the use of call centres and introducing brokers for offering services in the EU is communicated to applicant firms. The PRC notes that this position does not seem consistently enforced by CySEC in respect of firms which are already active as this is a practice actually used by some CySEC-authorised firms.
40. Applicants' reasons for their choice of place of establishment: most NCAs reported asking applicant firms to explain the reasons for their choice of place of establishment. Three NCAs [AFM, CNB, BaFin] further indicated that they check, at the authorisation stage, whether the largest part of the activities envisaged will take place in the home MS. This is to determine whether the filing of the application in this particular MS has an evident explanation. CySEC and MFSA reported asking the reasons for the place of establishment and that most authorised firms intend to operate in several EU MS, without a concentration in a specific MS.
41. Use of information and intelligence collected through cooperation with host NCAs: all NCAs indicated that they systematically and proactively use information and intelligence collected through cooperation with host NCAs when processing authorisation requests. For four of them [BaFin, CSSF, CySEC and MFSA], such systematic and proactive checks focus on information relating to the individuals and entities constituting the management body or persons effectively directing the business of the applicant firm, as well as its shareholders.

### **Assessment**

42. The application for authorisation is the first and a key opportunity for supervisors to review and understand a firm's cross-border plans, whether the firm is fit to operate cross-border and how cross-border services may affect its compliance with MiFID II requirements. Home NCAs should thus carry out such assessment in a thorough and probative manner. As indicated in the supervisory expectations set out in the mandate, it is important that NCAs: (i) have a defined supervisory approach in relation to the authorisation process and controls on firms that indicate at authorisation phase their plans to carry out cross-border activities; (ii) actually assess whether the firms' organisational structure and arrangements are adequate considering the nature and extent of their cross-border plans; (iii) use, when processing authorisations, information collected from other NCAs.
43. The PRC considers that overall NCAs do not have a demonstrable supervisory approach in relation to the authorisation process and controls on firms that indicate at authorisation phase plans to carry out cross-border activities. NCAs consider a firm's organisational structure and arrangements in general terms. They do not specifically assess such aspects in light of the firm's cross-border plans, although the specificities and risks attached to cross-border activities should deserve focused checks (for instance, whether and how the internal control functions will include a firm's cross-border activities in their monitoring and review activities).

44. The PRC however positively notes that two NCAs [MFSA and CySEC] have defined some elements of a supervisory framework for cross-border activities, by requesting firms to provide further information relating to the firm's cross-border plans. For MFSA, it includes how the firm is organised to operate cross-border and the related adequacy of the organisation. However, the PRC also notes that these controls on cross-border aspects are limited in scope (as they do not include specific controls in relation to the important aspect of the foreign languages in which cross-border activity may be carried out, and in particular whether internal control functions have capacity and processes to oversee the information provided to clients in local languages) and believes that MFSA could ensure more thorough scrutiny of all cross-border elements, in order to avoid tick-box assessments. The PRC notes that the focus on cross-border elements in CySEC's P&P relates to the firm's distribution network and marketing activities. CySEC's cross-border focus at authorisation stage would further benefit from clearly encompassing a larger scope such as whether the firm's organisation is adequate to carry out the cross-border activities envisaged. In addition, the PRC has duly taken into account the document on the "Activation Control programme" but it has not seen evidence of whether and how the cross-border elements listed in the document provided were systematically required and actually assessed by CySEC staff. Thus, the PRC could not conclude that CySEC applies a demonstrable thorough supervisory approach to the authorisation of firms with cross-border plans. This is particularly worrying when cross-border activity is a key part of the business of firms in a given jurisdiction; this is the case for CySEC as the vast majority of its firms carry out the biggest part of their business on a cross-border basis. Notwithstanding this concern, the PRC positively notes that, in light of unmanageable risks of investor detriment materialised in the past, CySEC introduced a prohibition on the use of call centres and introducing brokers for offering services in the EU. In light of the issues that are connected to such practices and came to light at the supervision stage on investment firms authorised in CY, the PRC notes that this appears a sensible approach. However, the PRC has not seen evidence that this position is consistently applied by firms and recommends CySEC takes further action on this aspect to ensure all firms abide by this rule.
45. The other four NCAs [CSSF, CNB, AFM, BaFin], could also not demonstrate having a supervisory approach to control firms' readiness to operate cross-border and to assess the nature, extent, risks and organisation of the envisaged cross-border activity. However, the PRC considers as a mitigating factor for CNB that a large portion of the cross-border activities provided by local firms is so far provided in SK, which shares a language also used or ordinarily understood in CZ.
46. The PRC was satisfied that all NCAs make use of information and intelligence collected through cooperation with and requests from host NCAs in their authorisation work. Requests for cooperation were done on a systematic basis regarding the fitness and propriety of individuals relevant to the applicant firm and on an ad hoc basis regarding previous requests for authorisations in other MS.
47. In terms of NCAs' individual assessment against the supervisory expectations set in the peer review mandate, the PRC assessed one NCA [MFSA] as largely meeting the peer review's expectations during the review period. In particular MFSA appears to have developed to some extent in their policies and practices controls to assess whether a firm's organisation structure and arrangements are appropriate to its planned cross-border activities. However, the peer review assessed that MFSA should improve the actual

scrutiny of the additional information provided by applicant firms and that these controls should be reflected in their authorisation P&Ps as well as in their passporting P&Ps.

48. The PRC identified five NCAs [CSSF, CNB, CySEC, AFM and BaFin] as partially meeting expectations regarding authorisations. For four of them [CSSF, CNB, AFM and BaFin], this is because they fell short in demonstrating a specific cross-border supervisory approach by which information collected in accordance with Article 6a of Commission Delegated Regulation (EU) 2017/1943 is used to sufficiently assess the firms' organisation and readiness for the provision of services in other jurisdictions.
49. [CySEC] was also identified as partially meeting expectations because, despite having some cross-border specific checks embedded in its P&P, it was not able to demonstrate how such additional controls were performed in practice. In addition, with regard to the volume of cross-border activities carried out from their jurisdiction, the client base targeted by their firms in other jurisdictions and the type of business often developed (speculative products), the failure to demonstrate a specific supervisory approach to firms' cross-border activities and qualitative and probative scrutiny on firms' cross-border plans assumes key importance when assessing the approach taken by CySEC in this area.
50. Most NCAs ask applicants the reasons behind their choice of the place of establishment, however, reasons accepted vary from one NCA to another and the assessment seems based on very broad criteria (the latter is also valid for MFSA).
51. To summarise:
  - a. AFM: partially meeting expectations
  - b. BaFin: partially meeting expectations
  - c. CNB: partially meeting expectations
  - d. CySEC: partially meeting expectations
  - e. CSSF: partially meeting expectations
  - f. MFSA: largely meeting expectations
52. In terms of good practices, the PRC notes that CNB asks applicant firms for a self-declaration on previous supervisory history or applications, so to support conducting relevant controls with other NCAs.

#### **4.1.2 Passport notifications**

53. The PRC assessed how home NCAs process passport notifications under Art. 34 of MiFID II, notably whether they: (i) process them completely and timely share them with host NCAs; (ii) reflect the relevant information in their monitoring systems and supervisory planning; and (iii) thoroughly scrutinise material changes (to the initial set-up of the firm at the point of initial authorisation, as laid out in Article 21(2) of MiFID II), if any, in relation to the passport notifications. For host NCAs it was assessed whether, if they become aware of cross-border services provided in their jurisdictions without a passport notification, they timely inform the relevant home NCA.
54. In this sub-section, the term "firm" refers only to investment firms.



## Summary of findings

55. Transmission of passport notifications: Two NCAs [CNB and CSSF] had no delay in transmitting passport notifications to host NCAs in the review period, while two other NCAs [MFSA and BaFin] had occasional short delays.<sup>34</sup> The remaining two NCAs [AFM and CySEC] reported slightly more frequent and long-lasting delays.<sup>35</sup> Two NCAs [BaFin and AFM] undertook remedial actions, respectively moving to encrypted emails in lieu of post and reorganising responsibilities for the assessment of passport notifications. Taking into consideration the absolute number of late notifications, and the causes for the delays CySEC considers them as not significant and therefore deemed that remediation actions were not necessary.
56. Transmission of written notices under Art 34(4) of MiFID II: four NCAs [AFM, CNB, CSSF, MFSA] transmitted written notices to host NCAs between 4 and 15 days. One NCA [BaFin] did not transmit six (out of 324) notices due to internal communication problems, to which they reacted by further automatising the process. For this NCA, the average forwarding time for other notices was 15 days. One NCA [CySEC] reported an average forwarding time of 30 days.
57. Information to investment firms: all NCAs proactively inform relevant firms that a passport notification was forwarded to the host NCA, except one [AFM] who does not inform firms as such but records this in an external register that firms can access on its website.
58. Processing of passport notifications: Four NCAs [BaFin, CySEC, MFSA, CSSF] have passport notifications policies which require the provision of specific information or performing ad hoc controls in relation to notifications received in addition to checking the completeness and accuracy of passport notifications received according to MiFID II (Article 34(3)) and Commission Implementing Regulation (EU) 2017/2382 (Articles 3 and 4). One of them [BaFin] has also a detailed checklist through which the relevant firm's supervisors may identify whether there are any reasons linked to the firm's conduct suggesting the need to halt the passport notification transmission.<sup>36</sup> The other two [AFM, CNB] have no additional controls provided for in their internal guidance.
59. One NCA [CSSF] indicated that MiFID II does not provide for the possibility to withhold accurate and complete passport notifications if the investment services and activities are covered by the firm's authorisation. One NCA [CySEC] also questioned whether the legal framework allowed to hold off passporting notifications in such circumstances. At the same time, two NCAs [BaFin, AFM] that analyse existing supervisory information indicated that the notification process should be stopped to conduct additional scrutiny where necessary.<sup>37</sup>
60. Lastly, one NCA [CNB] indicated that a recent amendment to national law provides that cross-border services provided to retail and professional clients on request under MiFID II in their jurisdiction from another EU MS are allowed under the freedom to provide services, i.e. without establishing a branch, only on a temporary or occasional basis. In practice,

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<sup>34</sup> MFSA - 1 delay out of 21 notifications (4%) lasting 11 days, due to concerns to be assessed; BaFin - 71 delays out of 1082 notifications (6.5%) of on average 1.85 days due to postal delays and Brexit-related peaks in notifications

<sup>35</sup> Respectively 13 out of 82 notifications (15%) for AFM, and 5 out of 53 notifications (9.4%) for CySEC, both with on average one-month delay

<sup>36</sup> BaFin also asks firms to submit a declaration to ensure their intention to comply with product intervention measures across MS.

<sup>37</sup> CySEC also informed the PRC that, outside of the review period, they had one case where they withheld passporting notifications due to supervisory concerns.

however, the NCA explained that due to the amount of passport notifications received on a regular basis, they apply this national law mostly through a risk-based approach, by mainly targeting firms subject to complaints.

61. Feeding passport notifications in monitoring systems / supervisory planning: all NCAs reflect passport notifications in their internal registers. Four NCAs [AFM, CNB, CySEC and MFSA] also update external registers. With regard to how passport notifications feed into the supervisory planning, monitoring systems or risk assessments, BaFin updates their main supervisory repository, which is used also in preparation of regular supervisory activities (e.g. annual audits) indicating when a passport was notified, for which MS and for which products<sup>38</sup>. It was not clear to the PRC how other NCAs integrated passport notifications in their monitoring systems and supervisory planning during the sample period.
62. Checks undertaken by the NCA when it receives a notification under Article 21(2) of MiFID II pertaining to cross-border aspects: For firms that did not indicate cross-border plans at authorisation phase, there might be cases in which the decision to start operating cross-border and notify a passport resulted or should have resulted in a notification of material changes under Article 21(2) of MiFID II. The PRC considers that there could be indeed cases where the decision to provide services in other MS is accompanied by a significant strengthening of the firm's arrangements and internal controls qualifying as a material change to the initial set-up of the firm at the point of initial authorisation.<sup>39</sup>
63. One NCA [AFM] was not able to answer the question because their systems do not differentiate notifications of material changes under Article 21 of MiFID II when they specifically relate to cross-border aspects. AFM was also not able to provide a relevant example. The other NCAs indicated that, where the relevant changes pertain to cross-border aspects, they are assessed as for authorisation applications.
64. HOST - All host NCAs, except CSSF (who did not encounter any such case) reported cases where they became aware of cross-border activities being carried out in their jurisdictions without a corresponding passport notification and reported these instances to the home NCA.

## **Assessment**

65. Passport notifications are an important step for firms to inform supervisors of their intention to operate cross-border. As indicated in the supervisory expectations in the peer review mandate, it is important that home NCAs transmit them to the host NCAs within one month and consider that once a firm transmits a passport notification, it can engage in cross-border services on that basis. Therefore, the characteristics and risks related to this type of activities need to be adequately reflected in supervisory systems.
66. Overall, the PRC considers that passport notifications are processed completely, rather swiftly, and with home NCAs informing, directly or indirectly, firms' on when they can commence their cross-border activities. At the same time, the PRC recommends that AFM align itself to the other NCAs so to directly inform firms when passport notifications are

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<sup>38</sup> This can impact the risk assessment of the firm based on the number of countries where firm may be active, see supervision sections below.

<sup>39</sup> This could be the case for instance of a firm authorised many years before the decision to commence cross-border activities, previously operating locally and then deciding to actively and substantially market services in other MS.

transmitted to host NCAs. The PRC also positively notes that two NCAs [AFM, BaFin] remedied instances of late transmission. By contrast, the PRC notes that one NCA [CySEC] is not taking action on the ~10% delayed notifications experienced as, based on their absolute number and their root causes, it deemed that remediation was not necessary.

67. The PRC is however concerned by the possibly unclear and inconsistent manner in which one NCA [CNB] applies the requirement that incoming cross-border activities in their jurisdiction are provided on a permanent basis only through a branch.<sup>40</sup>
68. For its assessment, the PRC focused on whether NCAs process passporting notifications received from the firms they supervise completely and timely share them with host NCAs. The PRC also looked at how NCAs reflect the relevant information in their monitoring systems and supervisory planning. As the PRC notes in subsequent sections of this report that NCAs are recommended to step up in the actual collection of cross-border data, the PRC invites NCAs to consider concurrently possible improvements to further integrate passporting notifications into NCAs' monitoring systems and supervisory planning in consideration of observations raised in this section.
69. Accordingly, the peer review assessment of NCAs in their home authorities role is as follows:
  - a. AFM: fully meeting expectations
  - b. BaFin: fully meeting expectations
  - c. CNB: fully meeting expectations
  - d. CySEC: fully meeting expectations
  - e. CSSF: fully meeting expectations
  - f. MFSA: fully meeting expectations
70. With regard to host NCAs, as indicated in the supervisory expectations in the peer review mandate, it is important that if they become aware of cross-border activities being carried out in their territory without a corresponding passport notification, they promptly inform the home NCA accordingly. Based on the instances reported, this was the case for all NCAs, except for CSSF which did not report cases where they became aware of such situations. Accordingly, the peer review assessment of NCAs in their host authorities role is as follows:
  - a. AFM: fully meeting expectations
  - b. BaFin: fully meeting expectations
  - c. CNB: fully meeting expectations
  - d. CSSF: not assessed
71. In terms of good practices, the PRC noted: (i) that all NCAs except AFM proactively inform firms that the passport notification has been submitted to the relevant host NCA(s), so to help ensuring that the firm does not commence activity in the host MS until the relevant

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<sup>40</sup> The PRC has not carried out any analysis on the compatibility of such Czech national law with the EU legislative framework, including with the requirements on the freedom to provide services under MiFID II.

NCA has been notified and that (ii) BaFin and CySEC developed a detailed checklist to analyse available supervisory information when processing the passport notifications.

#### 4.1.3 Arrangements for ongoing supervision

72. The PRC assessed whether home NCAs: (i) have and apply a demonstrable supervisory framework setting out how supervision is carried out in relation to cross-border activities; (ii) have systems or arrangements to identify which of the passported firms are actually active cross-border and collect and process on a regular basis relevant information to this end; and (iii) dedicate adequate operational resources (including IT systems and tools) to the supervision of firms' cross-border activities.

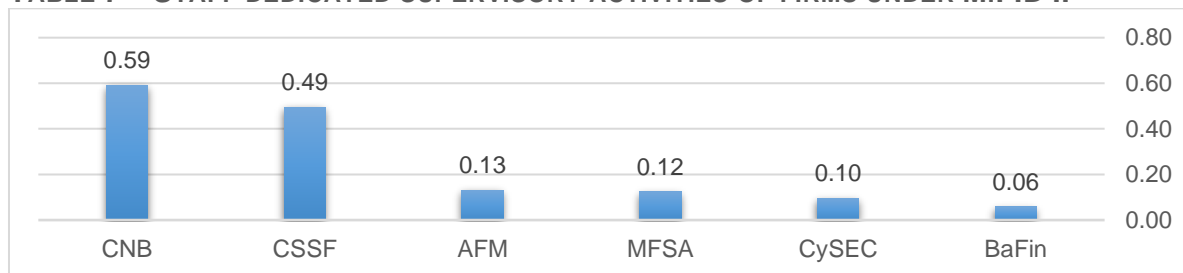
##### Summary of findings

73. Supervisory framework in relation to cross-border activities. Barring the policies and procedures on MFSA's risk-assessment model, none of the NCAs has policies and procedures specifically covering the supervision of firms' cross-border activities. In general, NCAs indicate that their supervisory framework does not differentiate between activities provided domestically and on a cross-border basis.
74. The risk-assessment model of one NCA [MFSA] contains a specific risk indicator related to firms' cross-border activities. In the MFSA's risk-assessment model, an additional weighting for cross-border activities is used to calculate a firm's risk score. This percentage adjustment varies based on the number of jurisdictions in which services can be provided, i.e. the higher the number of jurisdictions, the higher the firm's risk score. This number is based on the firm's passport notifications, not on the information collected by the MFSA on the firm's actual cross-border activities (see also paragraph 8479). The risk-assessment models of the other five NCAs [AFM, BaFin, CSSF, CySEC and CNB] do not contain specific indicators relating to firms' cross-border activities.
75. Although the risk-assessment model of one NCA [BaFin] does not contain a specific indicator on a firm's cross-border activities, the relevant handbook specifies that a firm's risk score can be overruled by the responsible supervision officer, leading to a higher risk score, based on whether the firm has 'foreign connections with potentially negative impact'. This includes, among others, a firm having 'a large number' of foreign customers. The PRC notes that this concept is not further specified. During the on-site visit, BaFin explained that significant cross-border activities do not necessarily result in a higher risk score for the firm in question since this may depend on other factors; the assessment of this element is therefore left to the responsible supervision officer without any further criterion or guidance provided to the staff. BaFin provided some examples in which the firm's risk score had been overruled due to the significant proportion of the relevant firm's cross-border activities.
76. One NCA [BaFin] indicates having annual audit controls on firms functioning as a 'base-layer' for its supervision. According to BaFin, in this context, publicly sworn auditors examine annually whether in principle all firms comply with the investor protection and organisational rules of MiFID II, including in respect of their cross-border activities. The PRC notes, however, that the mandate of such audits as prescribed by law and reflected in the relevant professional rules does not mention the examination of firms' cross-border activities and the specific risks they bring.

77. In relation to its risk-assessment approach, one NCA [CySEC] uses four different risk scores for firms, which determine the frequency and depth of CySEC’s monitoring activities: high risk, medium-high risk, medium-low risk, and low risk firms. According to CySEC, for high and medium-high risk firms, intense direct supervision and continuous assessment is applied. Each high and medium-high risk firm has a specific supervisory officer responsible for monitoring the firm (called the relationship manager). CySEC confirmed that each relationship manager is responsible for the monitoring of 30 high and medium-high risk firms on average. A supervisory action plan is prepared every year, specifying the inspections and reviews to be performed. The supervisory action plan for high and medium-high risk firms for 2020 shows a total of 83 high and medium-high risk firms, 58 of which provide services in relation to CFDs. For 17 of these, an on-site visit was planned for 2020. Moreover, the supervisory action plan includes planned desk-based “thematic” reviews (on inactivity fees, product intervention measures and withdrawal fees).

78. In relation to all NCAs, the PRC collected data on the number of supervisory staff dedicated to supervision of investment firms and credit institutions. The table below provides an overview of NCAs’ resources dedicated to supervision by measuring the total number of FTEs working on supervisory activities divided by the number of firms they supervise under MiFID II.<sup>41</sup>

**TABLE 7 – STAFF DEDICATED SUPERVISORY ACTIVITIES OF FIRMS UNDER MiFID II**



79. Collecting information on firms’ actual cross-border activities. The below table shows whether, in the review period, NCAs collected information on firms’ actual cross-border activities and what type of information was collected.

**TABLE 8 – INFORMATION COLLECTED ON FIRMS’ CROSS-BORDER ACTIVITIES**

| NCA   | Member states                        | Type of clients        | Number of clients      | Services provided      | Instruments involved |
|-------|--------------------------------------|------------------------|------------------------|------------------------|----------------------|
| AFM   | yes, but not available <sup>42</sup> | yes, but not available | No                     | yes, but not available | no                   |
| BaFin | No                                   | no                     | No                     | No                     | no                   |
| CNB   | yes, but not available               | yes, but not available | yes, but not available | No                     | no                   |

<sup>41</sup> It should be noted that the numbers below: (i) reflect the total resources dedicated to supervision of investment firms and credit institutions under MiFID II as it was not possible to collect consistent and precise estimates from NCAs of resources dedicated to the supervision of cross-border activities only; (ii) do not take into account BaFin’s supervisory model making use of a substantial number of external auditors functioning as a base layer to its supervision and which are not included in the figures.

<sup>42</sup> ‘Yes, but not available’ means that an NCA indicated to have collected the information in the review period but was not able to demonstrate that this information was embedded into the supervisory system and therefore readily available to supervisory staff (and to PRC members during on-site visits), also because the information was collected using a data system that was not designed for the purpose of cross-border supervision.

|                                   |                        |                        |     |                        |                        |
|-----------------------------------|------------------------|------------------------|-----|------------------------|------------------------|
| <b>CSSF investment firms)</b>     | yes, but not available | yes, but not available | No  | yes, but not available | yes, but not available |
| <b>CSSF (credit institutions)</b> | no                     | no                     | no  | no                     | no                     |
| <b>CySEC</b>                      | Yes                    | yes                    | yes | No                     | yes                    |
| <b>MFSA</b>                       | Yes                    | yes                    | yes | Yes                    | no                     |

80. Two NCAs [CySEC and MFSA] collected the information included in the table above on a quarterly basis. One NCA [CSSF] indicated collecting information on investment firms' revenues per MS, although they could not always provide such information to the PRC.
81. One NCA [CSSF] did not collect information on cross-border activities provided by credit institutions.
82. One NCA [CNB] did collect information on firms' activities in other MS but did not differentiate the information collected according to a firm's cross-border activities under the freedom to provide services and those provided through a branch. Therefore, CNB did not have information on the elements listed in the table specifically in relation to firms' cross-border activities.
83. One NCA [BaFin] did not collect information on firm's actual cross-border activities on a periodic basis. According to BaFin, this is due to the lack of an adequate legal basis to periodically request this data from firms on a market-wide basis. In addition, BaFin sees collecting this information as not necessary as they consider that firms' cross-border activities have been of minor importance compared to firms' overall activities. However, BaFin indicated that information on a firm's cross-border activities can be requested on an individual basis if need be, for example if there are alleged issues relating to such activities. The information can also be requested one-off on a market-wide basis if need be, for example because of a specific review to be carried out by the BaFin. Such a market-wide request was for instance carried out in February 2021.<sup>43</sup>
84. The PRC notes that none of the NCAs collecting information on firms' actual cross-border activities in the review period was able to show how the information should be (and actually was) used in their supervision. It also notes that some NCAs appear to have started collecting such data only in the context of the ESMA-coordinated data collection exercise.
85. Operational resources, including IT systems, in relation to cross-border activities. During the on-site visit, MFSA and CySEC were able to provide an overview of the information they had collected on firms' actual cross-border activities. AFM, CNB and CSSF were not able to provide such an overview, either because they had not developed adequate data systems enabling them to provide such an overview on firms' cross-border activities, or because they were not able to distinguish whether the information related to cross-border activities provided under the freedom to provide services or those provided through a branch.

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<sup>43</sup> BaFin also participated – for a sample of firms – to the cross-border template exercise organised by IPISC.

86. Moreover, during the on-site visit, MFSA was able to demonstrate how they calculate the risk score for firms providing cross-border activities, including the additional weighting applied based on the number of MS for which a firm had provided a passport notification.

### **Assessment**

87. Firms' cross-border activities carry specific risks and create additional challenges for effective supervision. Therefore, as indicated in the supervisory expectations set out in the mandate, it is important that an NCA has policies, procedures and a demonstrable supervisory framework which clearly set out how supervision is carried out in relation to cross-border activities and that NCAs dedicate adequate operational resources to the ongoing supervision of firms' cross-border activities. Furthermore, as firms' passporting notifications only provide information on the activities a firm is allowed to undertake, and not on the activities that are actually undertaken, it is expected that, in order to build adequate supervisory arrangements tackling risks arising from firms' actual cross-border activities, NCAs periodically collect and process information on these activities, at least relating to the jurisdictions in which the services are provided, the type(s) and number of clients involved, the type(s) of activities and services provided and instruments involved.
88. The PRC concludes that, however, no NCA has a supervisory framework that specifically covers firms' cross-border activities. None of the NCAs has P&P focusing on the supervision of firms' cross-border activities, even within the holistic approach adopted by NCAs. Regarding NCAs' risk-assessment models, only the MFSA's one takes cross-border risks into account. Although the PRC welcomes MFSA's risk-assessment approach, as it is based on the premise that cross-border activities can increase a firm's risk, the PRC recommends that MFSA uses information on a firm's actual cross-border activities, not a firm's formal passporting notifications, to determine the firm's risk score. Moreover, as indicated above, except for its risk-assessment model, MFSA does not have P&P focusing on the supervision of firms' cross-border activities.
89. The PRC acknowledges that in BaFin's risk-assessment approach, a firm's risk score can be overruled based on significant cross-border activities. Indeed, the PRC positively notes that this approach at least recognises that cross-border activities can increase a firm's risk. Nonetheless, the PRC is of the opinion that BaFin's risk-assessment model does not take firms' cross-border activities sufficiently into account because this overruling appears only to be applied in exceptional cases; it is also important to mention that the lack of collection of information on firms' cross-border activities on a regular basis deprives the model of an up-to-date basis to be analysed in order to assess the impact of these activities on the risk score. Moreover, based on the relevant policies and procedures, it is unclear in which cases such an overruling is exactly applied. Finally, in relation to BaFin's audit model, the current control framework does not identify the type of risks cross-border activities could entail nor the controls expected by the auditors in this respect.
90. Though the PRC considers the supervisory framework in relation to cross-border activities of all NCAs as inadequate, it believes that a distinction should be made on the basis of the nature, scale and complexity of firms' cross-border activities.
91. In three MS [DE, NL, CZ] the share of firms' cross-border activities appears to be relatively small compared to the firms' total activities. Still, the PRC expects the relevant NCAs to adjust their supervisory approach by taking cross-border activities specifically into account, also in light of the expectation that firms' cross-border activities will increase in the near

future (e.g. in the form of firms providing online execution services at relatively low cost to retail investors all over Europe).

92. CSSF stated that cross-border activities from firms authorised in LU would predominantly be carried out in MS on which CSSF has language capacity. The CSSF was unable to substantiate such a prevalence. Nevertheless, it appears that, based on firms' revenues communicated by CSSF, around 30% of this activity seems to take place in such MS. In the PRC's view, in those cases in which a language barrier is absent, an NCA could more easily monitor firms' cross-border activities.
93. In the case of CySEC the above mitigants do not apply: Cypriot authorised firms' cross-border activities constitute a substantial part of firms' overall activities. Indeed, most of Cypriot firms' activities consists of cross-border activities, often involving speculative products. Given the substantial cross-border activities of Cypriot firms, the PRC considers CySEC's lack of a supervisory framework that specifically covers firms' cross-border activities and their specific risks as a more significant shortcoming compared to those MS with a relatively small cross-border sector.<sup>44</sup>
94. In addition, the PRC notes that it has not seen evidence supporting CySEC's claim that it applies 'intense direct supervision and continuous monitoring' for high and medium-high risk firms. For example, the supervisory action plan for 2020 only includes planned on-site visits for 17 of the 83 high and medium-high risk firms. Moreover, in several cases the desk-based reviews included in this plan focus on relatively niche topics (e.g. withdrawal fees) rather than more fundamental ones relating to firms' organisations and conduct. Importantly, PRC considers this claim of intense direct supervision and continuous monitoring to be practically impossible in light of the sheer number of firms (30) each relationship manager should monitor. The PRC indeed agrees with CySEC that the intense direct supervision and continuous monitoring is essential to achieve effective supervision and address the significant risks of investor detriment related to such firms, most of which provide services in relation to CFDs combined with aggressive marketing strategies; however, in order to live up to the expectations of such an intense supervision and continuous monitoring, CySEC should significantly expand its staff dealing with supervision of investment firms. Indeed, the PRC views the provision of services in relation to CFDs in and of itself as a characteristic significantly increasing a firms' risk and therefore requiring more intense supervision on the firm.
95. CySEC is the second last NCA in terms of the number of supervisory FTE per firms. The PRC is of the view that, compared to other NCAs, there are considerable aggravating factors to be taken into account when assessing resources adequacy at CySEC, as identified in this and other assessment areas in this Section 4. Notably, (i) CY is the jurisdiction having the greatest significance of outgoing activities;<sup>45</sup> (ii) cross-border activities from Cypriot firms carry significant risks, with over 60% of Cypriot firms active on a cross-border basis offering speculative products, such as CFDs<sup>46</sup>, raising higher investor

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<sup>44</sup> While it is noted in the following sections of this report that – since most Cypriot firms are predominantly active cross-border, CySEC supervisory activities naturally reflected their cross-border presence, it is considered that CySEC supervisory framework should be more developed in considering, the nature, scale and complexity of firms' cross-border activities, including across each MS, so to be able to tailor monitoring and supervisory activities to each firms' specificities and risks.

<sup>45</sup> Considering (i) the number of firms providing cross-border activities relative to all Cypriot firms, (ii) the number of firms having a large client base cross-border (with firms often having thousands of clients abroad) and (iii) the share of Cypriot firms' cross-border activities relative to their domestic activities.

<sup>46</sup> Out of the 239 firms authorised, 148 provide services in relation to CFDs and 91 provide services in relation to other instruments.



protection concerns; (iii) the number of complaints and requests from other NCAs reported by CySEC in relation to cross-border activities is significantly higher compared to peers.<sup>47</sup> Based on these elements, the PRC is of the view that CySEC staffing is not proportionate to the nature, scale and complexity of the cross-border activities under its supervision.<sup>48</sup> The issue of insufficient resources is not only relevant for this assessment area but transversal to all areas assessed in this peer review.

96. With regard to the collection of information on firms' actual cross-border activities, the PRC positively notes that in the review period, four NCAs [AFM, CSSF, CySEC and MFSA] collected information on firms' actual cross-border activities in the review period in respect of different relevant aspects. At the same time, the PRC establishes that none of the NCAs collected information on all relevant aspects as identified in the mandate or on all firms<sup>49</sup> and recommends NCAs to do so in the future. Moreover, none of the NCAs was able to demonstrate how the information collected on firms' cross-border activities is integrated in their supervisory system and actually used in their supervision by staff, nor does any of the NCAs have policies and procedures to this end (with the limited exception of the MFSA's checks whether the information reported in the respective firms' passporting notifications is correct). This also seems related to the fact that most NCAs only started collecting such information in the context of the ESMA-coordinated data collection exercise and/or collected this information using a data system that was not designed for the purpose of cross-border supervision. The PRC expects NCAs to have policies and procedures aimed at actually using the information on firms' cross-border activities in their supervision, for example by taking such data into account when determining a firm's risk score, and to (further) develop their supervisory framework accordingly. This also applies to MFSA: even though its risk model has an indicator on firms' cross-border activities, the information collected on such activities is not used for this purpose.
97. Another NCA [CNB] collected information on firms' actual activities in other MS but it did not differentiate whether such activities are provided under the freedom to provide services or through a branch. As a consequence, CNB did not have a view of the volume, characteristics and risks of its firms' cross-border activities. As the responsibilities for the home and host NCAs differ significantly according to each of these regimes, the PRC recommends CNB to be able to distinguish the information according to whether activities are provided under the freedom to provide services or through a branch.
98. Only one NCA [BaFin] did not collect information on investment firms' or credit institutions actual cross-border activities on a periodic basis.<sup>50</sup> The PRC considers this as a substantial deficiency, as having basic information on firms' actual cross-border activities is key for effective supervision. Lacking such basic information, the validity of any claim that firms' cross-border activities are relatively insignificant can be questioned. In addition, there are signs that German firms' cross-border activities are becoming more significant. Without periodically collecting information on firms' cross-border activities, BaFin will not be able to monitor such developments and the risks these might bring. The PRC also observes that

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<sup>47</sup> Over 4,000 complaints in a two year-review period, as compared to an average of 62 complaints for the other NCAs in scope. Over 370 requests from other NCAs, compared to an average of 19.

<sup>48</sup> The PRC also notes that in a past peer review, concerns on the adequacy of supervisory resources were already raised on CySEC; this was specifically in the context of supervision of investment firms under MiFID ([Peer Review on Certain Aspects of the Compliance Function under MiFID I](#) – November 2017).

<sup>49</sup> Notably, CSSF collects all information suggested in the mandate, and goes beyond by requesting information on revenues from cross-border activities. However, this data collection is currently limited to investment firms and does not cover credit institutions.

<sup>50</sup> As explained in par. 91, BaFin indicated only collecting such information on a case-by-case basis.

the argument concerning an alleged lack of legal basis does not appear consistent with the NCAs' obligation to supervise firms' activities (including therefore cross-border ones) and indeed it does not seem shared by other NCAs which actually collect such information. The PRC recommends BaFin to start collecting this information on a regular basis.

99. In terms of IT systems and tools, the PRC concludes that two NCAs [CySEC and MFSA] developed tools to support supervisory activities on cross-border activities, as they were able to provide an overview of the information collected on firms' cross-border activities during the on-site visit. For the three NCAs [AFM, CNB and CSSF] that were not able to do so, the PRC concludes that they did not adequately develop such tools. One NCA [MFSA] was also able to provide an overview of firms' annual risk assessments including the additional cross-border weighting. The PRC notes that it did not assess whether other NCAs were able to demonstrate the firms' annual risk assessments against this expectation, as their risk-based approaches did not take into account any cross-border aspects. Lastly, one NCA [BaFin] could not at all be assessed against this expectation as it did not collect relevant information on firms' cross-border activities in the review period, nor did its risk-assessment model take cross-border risks sufficiently into account.

100. Accordingly, the peer review assessment is as follows:

- a. AFM: partially meeting expectations
- b. BaFin: partially meeting expectations
- c. CNB: partially meeting expectations
- d. CySEC: not meeting expectations
- e. CSSF: partially meeting expectations
- f. MFSA: largely meeting expectations

101. In terms of good practices, the PRC notes that CSSF collected information on investment firms' revenues generated per MS (although it also notes that the CSSF was unable to show how the information is used in its supervision). Furthermore, CySEC and MFSA collected the information on firms' actual cross-border activities on a quarterly basis.

#### **4.1.4 Day to day supervision**

102. The PRC assessed whether home NCAs, based on the nature, scale and complexity of the firms' cross-border activities (including the type of clients): (i) regularly monitor and assess cross-border activities undertaken by firms and relevant risks, including in terms of organisation, conduct and performance, and related complaints; (ii) make use of ongoing supervision tools (e.g. periodic engagements, reviews, sample checks etc); and (iii) put arrangements in place to be able to monitor activities carried out in a different language.

#### **Summary of findings**

103. Monitoring firms' cross-border activities. According to NCAs, firms' cross-border activities are covered by their general monitoring. NCAs indicated maintaining a holistic approach in the monitoring of firms having cross-border activities. This entails for instance monitoring of marketing communications, news, complaints (see below), information shared from other NCAs (see Section 4.1.6 on cooperation) and other sources such as

reports from firms' internal control functions or MiFID-compliance reports prepared by external auditors.

104. However, none of the NCAs provided evidence of monitoring which, although in the context of a holistic approach, could be able to capture specific risks or potential issues arising from firms' cross-border activities (e.g. monitoring of foreign language websites or marketing communications, relevant material and complaints in a foreign language) nor are there any mandates specifying what information auditors and/or internal control functions should verify on firms' cross-border activities when these activities are provided by firms in addition to domestic ones only.
105. One NCA [MFSA] has a specific tool to monitor firms' social media communications. Where a firm included in the tool's dashboard issues a post on the social media covered by the tool, the MFSA receives an alert. A supervision officer subsequently assesses whether the post is deemed to be marketing communication and if so whether it complies with the applicable requirements. Still, while the MFSA provided examples of assessing firms' social media communications in English, did not provide evidence of monitoring firms' social media communications in a different language which is where the firms' internal control activities (and any corresponding NCA's supervision) may become more complex.
106. Monitoring of complaints relating to cross-border activities. All NCAs were able to identify complaints received directly from firms' clients or from host NCAs in relation to firms' cross-border activities.<sup>51</sup> The table below shows the number of complaints in relation to firms' cross-border activities received directly from firms' clients, from firms, and/or from host NCAs in the review period as reported by the respective home NCA, from highest to lowest. The MFSA was only able to provide the data for half of the review period, so the actual number of complaints received will most likely be higher.

**TABLE 9 - COMPLAINTS RECEIVED**

| NCA          | Number of complaints received |
|--------------|-------------------------------|
| <b>CySEC</b> | 4194                          |
| <b>MFSA</b>  | 147                           |
| <b>CSSF</b>  | 96                            |
| <b>AFM</b>   | 52                            |
| <b>BaFin</b> | 15                            |
| <b>CNB</b>   | 1                             |

107. NCAs have different approaches to monitor complaints and make use of them in their supervision. For instance, firms can be requested to produce a detailed report on a monthly or annual basis with all complaints received classifying them under detailed pre-defined categories.
108. Use of ongoing supervision tools. None of the NCAs provided evidence of regularly using ongoing supervision tools to check whether firms' cross-border activities comply with applicable rules (including organisational and internal control requirements).
109. Three NCAs [AFM, CSSF and CySEC] provided some evidence of the use of periodic engagement tools in which firms' cross-border activities are covered. Examples provided

<sup>51</sup> The PRC notes, however, that the AFM was only able to identify such complaints very late in the process of the review.

are regular meetings with a firm's senior management in which cross-border aspects are covered. One NCA [MFSA] systematically covers a firm's cross-border activities in the on-site visit held for recently authorised firms.

110. Five NCAs [AFM, CSSF, CySEC, BaFin and MFSA] provided some evidence of the use of review tools with respect to firms' cross-border activities. Examples are the review of firms' compliance, risk and internal audit reports and the review of firms' websites and marketing communications. Out of these, one NCA [BaFin] provided some evidence of the review of the audit reports provided annually by the external auditor in which firms' cross-border activities were covered.
111. Three NCAs [BaFin, CySEC and MFSA] provided some evidence on the use of sample checks tools in their ongoing supervision of firms' cross-border activities. Out of these, one NCA [BaFin] provided some evidence of the review by the external auditor of samples taken with respect to firms' clients serviced on a cross-border basis.
112. One NCA [CNB] did not provide evidence on the use of ongoing supervision tools on specific cross-border activities.
113. Language requirements and capabilities. All NCAs [AFM, BaFin, CNB, CySEC, CSSF and MFSA] have specific language requirements regarding the information provided to them by firms under their supervision. Usually, firms are required to provide the information in the native language(s) or in English.
114. None of the NCAs provided evidence of supervisory activities (e.g. monitoring) in relation to firms' marketing communications in a language other than those accepted in their supervision.
115. CNB provided evidence that their firms' cross-border activities are mostly concentrated in Slovakia, which has a similar language as CZ. Still, the PRC notes CNB's firms also provide activities in other MS the national languages of which are different, albeit to a limited extent.

## **Assessment**

116. Monitoring of firms' cross-border activities provides an overview of the risks involved and serves as a basis for the prioritisation of further and more specific supervisory actions. As defined in the supervisory expectations set out in the mandate, home NCAs should monitor the overall cross-border activities of authorised firms and the relevant risks, and complaints received in relation to firms' cross-border activities, and process the information in order to identify which firms or activities may need prioritisation. Furthermore, based on the nature, scale, and complexity of authorised firms' cross-border activities and of the financial instruments used, including the types of clients of the firm, home NCAs should make use of ongoing supervision tools such as periodic engagements, reviews and sample checks to regularly check that firms' cross-border activities are carried out in compliance with applicable rules.
117. Relevant documentation in relation to a firms' cross-border activities (e.g. websites, client agreements, marketing communications, records of telephone conversations) is often written / performed in a language other than the native language of the NCA or English. To be able to assess such information and thus to ensure effective supervision of firms' cross-border activities, it is expected that home NCAs have in place, with respect to

the information that firms provide to the NCA, reporting or translation requirements that would allow the NCA to monitor activities carried out in a different language.

118. Monitoring firms' cross-border activities. The PRC considers the monitoring activities performed by NCAs in relation to firms' cross-border activities as insufficient since none of the NCAs gives specific prominence to firms' overall cross-border activities in its monitoring approach. Absent such monitoring activities, NCAs' supervision will remain mostly reactive rather than proactive, for example because issues relating to a firm's cross-border activities are only identified after a complaint or request has been received from a host NCA. The PRC therefore recommends that all NCAs include firms' cross-border activities as such in their monitoring approach, alongside the monitoring of firms' domestic activities.
119. In light of their firms' substantial cross-border activities, the PRC acknowledges that the monitoring activities of two NCAs [CySEC and MFSA] will somehow also cover such firms' cross-border activities (e.g. because a firm being monitored has substantially more cross-border than domestic activities). Still, the PRC also considers the approach of these two NCAs as insufficient since it is unlikely that such an approach will uncover some significant cross-border risks, for example those emanating from firms' marketing communications in a different language.
120. The PRC views the tool used by the MFSA to monitor firms' marketing communications on social media as a good practice but notes that it has not seen any evidence of monitoring firms' marketing communications in a different language than English. As it is likely that firms will have specific marketing communications for each MS they operate in, the PRC recommends the MFSA to include such communications also in its monitoring activities through the tool.
121. Monitoring of complaints relating to cross-border activities. The PRC positively notes that all NCAs were able to identify complaints received directly from firms' clients or from host NCAs in relation to firms' cross-border activities, although, in the case of the AFM, only very late in the process of the review. Importantly, however, that there is a substantial difference between NCAs in terms of the number of complaints in relation to cross-border activities in the reporting period, with CySEC reporting by far the highest number. The PRC considers the number of complaints as an indicator of the quality of the activities provided by firms and the risks involved.
122. The significant number of complaints concerning firms under CySEC supervision, as well as the quality of the supervisory response, in terms of identifying and using relevant supervisory tools (see also sections below on investigations) therefore leads the PRC to question the effectiveness of CySEC's supervisory approach in relation to firms' cross-border activities. The PRC is aware that the higher number of complaints related to cross-border activities by Cypriot firms as compared to firms from other MS also reflects the relatively high volume of cross-border activities outgoing from Cyprus. However, this does not explain why CySEC's number is so much higher than those from the other NCAs (being a multiple of complaints concerning the other five NCAs altogether).
123. Use of ongoing supervision tools. Even though five NCAs provided some evidence of the occasional use of ongoing supervision tools to check whether firms' cross-border activities comply with applicable rules, none of the NCAs was able to demonstrate the use of such tools on a regular basis, based on the nature, scale and complexity of firms' cross-border activities (including for example the financial instruments used and the type of

clients of the firm), nor did they provide relevant or a clear set of controls and criteria on the use of such tools based on cross-border specificities and risks. Consequently, the PRC considers that no NCA made sufficient use of ongoing supervision tools in relation to firms' cross-border activities. One NCA [CNB] failed to provide some evidence on the use of such ongoing supervision tools.

124. In other words, for all NCAs, the PRC notes that ongoing supervisory tools dealt with firms' cross-border activities only occasionally and incidentally without any focus on these activities (and their relevant risks) in the planning phase of the deployment of these tools and without any ex-ante indicator which could allow identifying the need to proactively focus on a given firm's cross-border activity in certain circumstances.

125. One NCA [BaFin] indicated having annual audit controls on in principle all firms by publicly sworn auditors, in the course of which different types of ongoing supervision tools are used. The PRC notes however that the BaFin only provided limited evidence on the (sporadic) use of such tools in relation to cross-border activities. Moreover, in relation to the monitoring activities and use of ongoing supervision tools referred to by BaFin, the PRC observes that these are in fact activities carried out by the firm's external auditor, not activities carried out directly and primarily by BaFin staff. The PRC takes note of the fact that the annual audits can provide a useful source to be used in an NCA's supervision. At the same time, it also stresses that activities performed by the firm's external auditor cannot be substituted for supervisory activities performed by BaFin staff. As noted in the investigations section, BaFin, out of over 250 firms active cross border, carried out in the two-year review period only two staff-driven activities on cross-border related topics in addition to the audit layer. In order to have an adequate view of the characteristics and risks posed by firms' cross-border activities, and to be able to act when necessary, the PRC believes it is necessary that BaFin can rely on its own observations, based on primary sources, not only or mostly on observations by the firm's external auditor. The PRC therefore recommends BaFin to scale up its own supervisory activities. Indeed, BaFin has very little if no information on firms' cross-border activities coming from supervisory work carried out by BaFin's own staff. The PRC notes that findings in relation to BaFin's own supervisory capacity and activities in addition to the external auditors, were also raised in past peer reviews, notably: (i) peer review into supervisory actions aiming at enhancing the quality of data reported under EMIR; and (ii) Peer Review on the collection and use of STORs.

126. Language requirements and capabilities. The PRC positively notes that all NCAs have specific language reporting requirements for firms under their supervision.

127. However, notwithstanding such language requirements, they do not appear to proactively monitor relevant documentation on firms' cross-border activities written in language other than the native language of the NCA or English. The PRC considers this as a significant drawback as proactive monitoring is key to identifying risks in an early stage. This drawback applies to a lesser extent to CNB, as their firms' cross-border activities are mostly concentrated in Slovakia, on the national language of which CNB has language capacity.

128. In light of this, the peer review assessment is as follows:

- a. AFM: partially meeting expectations

- b. BaFin: partially meeting expectations
- c. CNB: partially meeting expectations
- d. CySEC: not meeting expectations
- e. CSSF: partially meeting expectations
- f. MFSA: partially meeting expectations

129. In terms of good practices, the PRC notes that MFSA uses a dedicated tool to monitor firms’ social media activities. Moreover, MFSA and CSSF conduct post-authorisations onsite visits (around 6-12 months) after the firm has been authorised / has commenced its activities to take stock of how the firm is operating compared to the authorisation application.

#### 4.1.5 Investigations and inspections

130. The PRC assessed whether and how home NCAs: (i) use intrusive supervisory tools such as investigations and inspections in relation to cross-border activities; (ii) require and oversee remediation of shortcomings identified therein; (iii) check that firms using tied agents or third parties in cross-border activities undertake adequate due diligence and oversight. Further it was assessed whether and how they deal with host NCAs’ requests to launch investigations / inspections.

##### Summary of findings

131. Use of intrusive supervisory tools such as investigations and inspections. NCAs provided the following number of investigations / inspections they conducted over the review period.

**TABLE 10 – INVESTIGATIONS AND INSPECTIONS PERFORMED**

| NCA          | Number of performed investigations / inspections | of Where cross-border activities were looked at | Where cross-border activities were looked at | Of which on-site inspections (out of the number in the 2 <sup>nd</sup> column) | With a specific focus on cross-border activities only | Where host NCAs’ assistance was requested / used |
|--------------|--|---|--|--|---|--|
| <b>AFM</b>   | 42   | 9   | 2  | 9  | 3   |  |
| <b>BaFin</b> | No data  | No data   | 0  | 2  | 2   |  |
| <b>CNB</b>   | 26   | 7   | 7  | 0  | 0   |  |
| <b>CSSF</b>  | 15   | 8   | 8  | 0  | 0   |  |
| <b>CySEC</b> | 214  | 214   | 29   | 214  | 0   |  |
| <b>MFSA</b>  | 18   | 9   | 9  | 0  | 0   |  |

132. The PRC notes that there is no unified definition of investigations / inspections among NCAs. For instance, one NCA [BaFin] considers as investigations any supervisory activities beyond the base layer annual audit reviews. To the contrary, a couple of NCAs [MFSA, CNB] only reported as “investigations / inspections” relevant to cross-border activities their on-site inspections. Further, these investigations / inspections are not reflective of the

number of firms covered as for some NCAs several investigations / inspections covered the same firm.

133. In addition, the cross-border focus of these investigations / inspections covers different realities and interpretation across NCAs, as further detailed below.
134. From the answers provided and the on-site visits held by the PRC, it can be inferred that most NCAs did not conduct investigations / inspections with a specific focus on cross-border matters; rather, cross-border activities were incidentally covered in the scope of investigations / inspections focusing on more transversal matters in relation to firms generally identified by virtue of their domestic activities (and which also provided services cross-border). One NCA [CySEC] indicated that all the investigations / inspections reported had a specific focus on cross-border activities; this is due to the large predominance of cross-border activities as compared to domestic ones. However, such investigations / inspections covered general aspects relating to firms with cross-border activities (e.g. best execution) and were not focusing on cross-border themes and risks as such (e.g. marketing communications used in other MS). Likewise, three NCAs [AFM, CNB, CSSF] have included in such number some investigations / inspections that covered cross-border activities (and in some cases investigations / inspections were conducted on firms significantly active cross-border) but the topic on which the investigation / inspection was focusing was of a more transversal nature (e.g. classification of retail clients, marketing communications in domestic language), without any specific focus on cross-border activities. The PRC also asked NCAs to clarify how cross-border specific issues were looked at in the investigations, for example whether the selection of samples took into account where the relevant firm is active and to what extent. For no NCA it was noted that there was a deliberate sample selection considering cross-border elements and risks. Only one NCA [BaFin] was able to demonstrate cross-border specific supervisory activity with respect to supervisory activities on two<sup>52</sup> firms' cross-border activities, initiated following concerns raised by host NCAs or third parties.<sup>53</sup>
135. The PRC further noted that one NCA [CySEC] targets an annual investigation / inspection for all high and medium-high risk firms. CySEC indicated not to have met this target and that the 214 investigations / inspections conducted in the two-year review period covered 90 firms.
136. Moreover, the PRC notes that following some investigations, CySEC identified alleged shortcomings of firms in relation to several MiFID II organisational and conduct of business requirements (for instance, for the same firm, shortcomings relating to the unauthorised provision of investment advice, the compliance function, conflict of interests, acting in the client's best interests (including aggressive sales practices), best execution, fair and not misleading information disclosure, and record keeping). The PRC notes that while in some of these cases CySEC summoned the firm to make written representations on the individual shortcomings, it has not seen evidence of an assessment of the overall impact of such serious behaviours on the firms' ability to provide services in a compliant way.
137. Requiring and overseeing remediation of shortcomings identified during investigations / inspections. NCAs were requested to provide (i) five examples of actions taken /

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<sup>52</sup> One of which initiated right at the end of the review period and is still ongoing

<sup>53</sup> BaFin also decided to undertake after the review period (external) audits on certain credit institutions, to focus on the cross-border aspects of the activities of the audited entities.



requested with regard to shortcomings identified specifically in relation to cross-border activities and (ii) five examples of shortcomings identified specifically in relation to cross-border activities which were not followed up / remediated.

138. Two NCAs [CySEC and CNB] provided the totality of the requested examples. Others did not provide the requested number of examples [MFSA, AFM, CSSF] or did not provide examples at all [BaFin]. The reasons given were that no shortcomings were identified in relation to cross-border activities [BaFin<sup>54</sup>], a smaller number of shortcomings relating to cross-border activities was identified [AFM, MFSA, CSSF] and, in relation to (ii) above, all shortcomings identified were followed up [CSSF, MFSA]. In the majority of examples provided, the shortcomings identified were of a transversal nature covering also cross-border activities (sometimes only potentially) but were not specifically related to cross-border aspects of the business of the investigated / inspected firms, in line with the findings described in Section 4.1.4 above.
139. For three NCAs [CSSF, MFSA, CySEC], it was mentioned that the follow up includes a mix of evidence-based follow up, whereby the NCA is provided with relevant evidence of the remediation occurred, and self-declaration by the firm without corresponding evidence. CSSF also indicated that they often follow up through the annual review by firms' internal control functions as well as through the Long Form Report drafted by the external auditor of the firm. One NCA [CySEC] reported that they rely on inspections and reviews of ad-hoc reports from the relevant firms' control functions. It is however not clear what would trigger such inspections and reviews of internal control functions' reports.
140. Where NCAs provided examples of shortcomings identified in relation to cross-border activities and they were not followed up [CySEC], the reasons given were the firm voluntarily renounced to the authorisation [CySEC] and the relevant firm was a low-risk firm [CySEC].
141. Requests for co-operation. Two NCAs [AFM, BaFin] reported that they requested assistance from a host NCA to conduct an investigation / inspection, while the others did not experience such cases of request for cooperation from the home to the host NCA.
142. With regard to requests for cooperation from host to home, NCAs were requested to provide the number of instances in which, as home NCA, they did not follow up on a request to open an investigation / inspection from a host NCA. Four NCAs [BaFin, CNB, MFSA, and CSSF] reported that they did not receive any such request from a host NCA within the period under review. One NCA [AFM] received a request but had already opened an investigation /inspection on the same firm and matters due to its own concerns. One NCA [CySEC] reported that they are not in a position to provide such specific figure due to the high number of cooperation requests received (not only requests relating to the opening of an investigation) and the disproportionate time it would take to retrieve such information.
143. The reasons given by NCAs for not following up on a request for cooperation from host NCAs are: the relevant entity / matters were already being investigated [AFM] or rectified [CySEC], the issue is classified as low risk [CySEC].

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<sup>54</sup> For the three investigations carried out by BaFin on cross-border activities, one is ongoing, one showed that the alleged shortcomings did not subsist, one lead to renunciation of the licence by the firm.

144. NCA's verifications of firms' oversight over tied agents or third parties used in cross-border activities - Five NCAs [BaFin, CSSF, MFSA, CNB, CySEC] out of the six NCAs reported that they do verify (as part of their supervisory activities or investigations / inspections) whether firms using tied agents and third parties for their cross-border activities have effective internal controls and oversight (policies, procedures, control measures, etc.) on these third parties' organisation and activities, and perform due diligence of the same. One NCA [AFM] reported that it does not check such points in the course of their supervisory activities or investigations / inspections.
145. Of the five NCAs that have a process in place for this, there are some variations as to how these assessments are performed:
- One NCA [BaFin] resorts primarily to the external audits on which they base a large part of supervisory activities, as well as on ad hoc audits, reports by the firms' internal control functions.
  - One NCA [CSSF] uses the Long Form Report<sup>55</sup> of the respective firm as a supervisory tool. This report is issued on a yearly basis. The NCA reported that such report covers the activities and organisation of the firms in a holistic manner, including tied agents. If any issues are detected based on the report further investigations / inspections can be triggered (such as onsite inspections or non-contentious administrative proceedings). Furthermore, CSSF reported that cross-border activities rendered by investment firms or credit institutions through the use of tied agents are systematically included in its full scope MiFID II on-site inspections. However, they do not directly inspect how the tied agents provide the services to clients nor do they specifically select any client files of the clients serviced by tied agents.
146. One NCA [MFSA] uses a combination of supervisory tools. First, at authorisation stage, firms are required to detail the type of compliance checks to be undertaken in order to keep track of the activities occurring within third party entities (not only for cross-border activities). For ongoing supervision, MFSA makes use of a combination of unannounced inspections, review of the firm's outsourcing policy, desk-based review of firms' service level agreements, questions to the firm's compliance function, review of its compliance monitoring programme as well as compliance reports to check which due diligence and controls are foreseen and whether they have been carried out.
147. One NCA [CNB] reported that checks would be performed by the NCA but on outsourcing in general, not specifically in relation to cross-border activities. However, such NCA also reported that, for the review period, no firm under supervision used tied agents or third parties for its cross-border activities.

### **Assessment**

148. According to the supervisory expectations set out in the mandate, it is expected that home NCAs use intrusive supervisory tools such as investigations and inspections in relation to cross-border activities and follow up to shortcomings are identified overseeing remediation. It is also expected that if a home NCA does not open an investigation or inspection following a request to this end by a host NCA, it notifies and explains the

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<sup>55</sup> An annual report produced by the external auditor of the firm describing in detail the activities carried out by the investment firm during the year under review and of the related risks.

rationale to the host NCA. Finally, when an authorised firm makes use of tied agents or introductory entities in its cross-border activities, a home NCA should check that the firm has effective internal controls and oversight (policies, procedures, control measures, etc.) on these third parties' organisation and activities.

149. The PRC considers that, in the review period, NCAs generally did not sufficiently focus on firms' cross-border activities in their investigations / inspections. While NCAs indicated that they do cover firms' cross-border activities as part of holistic investigations / inspections focused on transversal topics (such as product governance, classification of retail clients as professionals ...), the actual focus on cross-border activities was limited, for example in terms of samples reviewed or elements looked at (such as marketing activities). The absence of focused use of more intrusive supervisory tools by NCAs on cross-border aspects specifically is in line with the peer review's findings on NCAs' day-to-day supervision of cross-border aspects (Section 4.4 above): without adequate monitoring on these aspects, signs of shortcomings are not detected, and the consequent use of investigations / inspections seemingly is not necessary.

150. The numbers of investigations / inspections reported by each NCA in the review period vary greatly. Apart from what is mentioned below for BaFin, the peer review could not draw conclusions as to whether the overall use of intrusive supervisory tools was adequate. Indeed, the numbers reported cover different realities, the numbers of investigations / inspections are computed differently by each NCA and also most of them are not specific to cross-border activities. For CySEC, the PRC considers that the objective to conduct investigations / inspections on all high and medium-high risk firms was reasonable in light of the substantial risks related to such firms, all operating cross-border; at the same time the PRC has to record CySEC's failure to achieve this objective.

151. Moreover, the PRC concludes that CySEC does not seem to sufficiently identify or assess the root causes of a firm exhibiting serious non-complaint behaviour so as to be able to take measures proportionate to the shortcomings identified. The PRC observed some investigations that appeared thorough and in which relevant shortcomings seemed to be identified. However, even in cases in which the firm committed breaches relating to several important MiFID II organisational and conduct of business requirements<sup>56</sup>, CySEC did not take a comprehensive view to the overall attitude of the firm, assessing the drivers behind such behaviour, and consequently, the remedial actions requested to the firm were not adequate in bringing structural and long-lasting changes and the supervisory response thus remained ineffective.<sup>57</sup> The PRC believes that this is also an important factor

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<sup>56</sup> As indicated in the findings, for the same firm, shortcomings relating to the unauthorised provision of services, the compliance function, conflict of interests, acting in the client's best interests, best execution, fair and not misleading information disclosure and record keeping.

<sup>57</sup> For instance, in one case, the CySEC expressed its concerns about a firm's intention to comply with CySEC's instructions and circular C181 regarding the actions of the individuals that communicate with clients since such firm was continuing to present weaknesses and apply aggressive practices. CySEC originally envisaged that the only possible way for this firm to comply with the relevant requirements and change its practices was to change its business model and to terminate permanently the communication with clients with the exception only to allow a welcome phone call to new clients or whenever the customer requests it himself (e.g when he faces technical issues). CySEC however, eventually decided instead to draw the firm's attention to its conduct of business obligations under MiFID II and to rely on the firm's self-assessment that remedial actions had been taken (submission of an auditor's internal report regarding the firm's compliance with its MiFID II cob obligations as well as a confirmation signed by all Board members, which certifies that the firm has fully complied with its obligations).

In another similar case, CySEC's supervision department expressed its concerns about the firm's intention to comply with CySEC's instructions regarding the actions of its employees communicating with clients and/or potential clients that followed an on-site inspection. CySEC originally considered similar measures to the case described above (change of the firm's business model and ending calls to clients except in limited cases). CySEC's eventually decided however, to proceed with a settlement for possible violations concerning the findings from the on-site inspection, giving the firm a 3-month period to take corrective measures.

explaining why issues related to several non-compliant firms, though already on CySEC's radar, drag on for too long, resulting in a high risk of retail client detriment lasting well after the initial identification of a given problem or leading to the reiteration of non-compliant behaviours.

152. BaFin demonstrated to make use of investigations specific on cross-border activities, although on a very sporadic basis. They showed to have a clear process to monitor shortcomings (even if the actual functioning could not be assessed through real examples) and to ensure that sufficient oversight is exerted on tied agents. However, BaFin was found to make very little use of these more intrusive tools compared to the amount of firms active cross-border, and to use it only in a reactive manner when serious suspicions arise. While BaFin's base layer supervision comprises annual audits on all firms, investigations / inspections provide for an important intrusive and deep dive tool into specific risks and problems and should be carried out more substantially. Furthermore, the investigations / inspections carried out by BaFin all originated by shortcomings or risks reported by third parties (NCAs or other stakeholders) and were not identified through BaFin supervisory activities or annual audit, which, therefore, apparently did not cover all aspects relating to the firm's organisation and activities and/or did not go deep enough. BaFin did not identify through their ongoing supervisory activities the need to conduct any other investigations / inspections apart from the ones referred above. As noted also in the day-to-day supervision and enforcement section, the PRC is concerned that this could be linked to insufficient supervisory activities on cross-border services.
153. Regarding remedial actions, NCAs sometimes did not provide the number of examples requested. In other cases, the examples provided were related to transversal topics, also covering cross-border activities, but were not focused on cross-border activities specifically. The main reason given is the absence or insufficient number of shortcomings identified in relation to cross-border activities. The PRC takes note of this reason; however, as already mentioned above, this could be a consequence of the absence of adequate specific monitoring of firms' cross-border activities. That being said, the PRC positively notes that when shortcomings were identified, NCAs showed evidence that remediation actions were taken. For CSSF, MFSA and CySEC, the peer review recommends that the NCA's follow-up on firms' remediation actions is more thorough and evidence-based and less reliant on firms' confirmation (by conducting instead dedicated evidence review / engagement).
154. When NCAs reported that remediation actions were not taken, the reasons reported seemed reasonable.
155. Regarding cooperation in the area of investigations / inspections, it seems that requests from home to host NCAs are very limited. Based on the few examples provided by NCAs, the PRC was satisfied that the cooperation in this area seemed to be working well, thereby adding value to the investigations / inspections performed. Regarding cooperation requests from host to home NCAs, the majority of NCAs [BaFin, CNB, MFSA, and CSSF] reported that they had not received any requests during the review period. For the other two NCAs [CySEC and AFM], the reasons given for not following up on a cooperation request received from a host NCA generally seemed reasonable. The PRC is however concerned that one NCA [MFSA] reported legal impediments as one reason for sometimes not being able to follow up on cooperation requests.

156. When it came to NCAs' checks on firms' oversight and due diligence on tied agents and third parties used in cross-border activities, two NCAs [CSSF, BaFin] demonstrated the inclusion of the activities of tied agents in their full scope investigations / inspections. However, the PRC noted that such inspections / investigations were focusing on how firms were monitoring and controlling the activities of their tied agents. The peer review would recommend NCAs also include in their investigations / inspections the activities of the tied agents themselves by, for instance, selecting client files of clients of the tied agents.

157. The peer review assessment of NCAs is as follows:

- a. AFM: partially meeting expectations
- b. BaFin: partially meeting expectations
- c. CNB: partially meeting expectations
- d. CySEC: partially meeting expectations
- e. CSSF: partially meeting expectations
- f. MFSA: partially meeting expectations

158. The above assessment is based on the following considerations:

- NCAs could not demonstrate the use of intrusive supervisory tools for the supervision of cross-border activities specifically. While this could be the basis for assessing NCAs as not meeting expectations, the PRC acknowledges that NCAs did, however, show instances in which they occasionally cover cross-border activities when using investigations and inspections to supervise more transversal topics;
- when shortcomings are identified, NCAs could demonstrate that they took remediation actions or that they had a reasonable reason not to. Some NCAs [CSSF, CySEC] however may on some occasions overly rely on firms' confirmation of remediation action rather than directly checking that the necessary measures have been implemented;
- for the supervision of firms' oversight on tied agents and third parties used in cross-border activities, NCAs demonstrated that such activities are included in their full scope investigations / inspections. However, investigations / inspections performed by NCAs on tied agents focus on how the firms monitor the activities of the tied agents but not directly on the activities of the tied agents.

#### **4.1.6 Cooperation and exchange of information**

159. The PRC assessed whether host NCAs effectively support home NCAs in their cross-border supervision by providing in a clear, structured, coherent, and secure manner information and complaints they may have which is relevant for their supervision of cross-border activities. Further, the PRC assessed whether both home and host NCAs: (i) timely and satisfactorily handle respective requests for consultation, cooperation, assistance, information, and (ii) make such requests in a precise and focused manner.

#### **Summary of findings**

160. HOST - Transmission by the host NCA of information, including complaints, on firms' cross border activities to the relevant home NCA. Two NCAs [AFM and BaFin] provided a

few examples of information transmitted to the relevant home NCA in the review period. The examples cover complaints received by the host NCA on incoming firms' cross-border activities, or issues identified by the host NCA relating to topics such as the firm's best execution arrangements and costs and charges disclosures. In the examples, the issue is explained, an initial assessment made, as well as an offer to provide additional information if necessary. The other two NCAs [CSSF and CNB] did not provide examples of information, including complaints, transmitted to the relevant home NCA because they did not have such occurrences during the review period.

161. Two NCAs (BaFin and CNB) have P&P covering the transmission of information, including complaints, to the relevant home NCA, containing provisions to ensure that the information provided is clear, structured, and coherent. CNB had a restrictive interpretation during the review period in that they considered it necessary to send complaints to home NCAs only if CNB had clear and demonstrable grounds of alleged wrongdoing. Subsequently, CNB updated their practices, so to transmit complaints more widely to home NCAs.
162. The other two NCAs [AFM and CSSF] do not have such P&P.
163. HOME / HOST - Handling of request for consultation, cooperation, assistance or information from other NCAs. Five NCAs [AFM, BaFin, CNB, CySEC and MFSA] have P&P on the handling of requests from other NCAs. These cover both requests received in the home and host capacity. Usually, the coordination is done by a specific department, which receives the requests, makes a first assessment and subsequently involves other department(s) depending on the nature of the request. The relevant department then determines whether the information may need to be requested from the firm(s) in question, to which a timebound information request is sent. After receiving the necessary information, an answer to the request is drafted and sent to the requesting NCA by the coordinating department.
164. Three NCAs [AFM, CNB and CySEC] also have guidance in place for the timeliness of handling requests from other NCAs. The PRC notes however that in the case of the AFM, the document containing this guidance has only been in application since 2019 and includes track changes.
165. One NCA [CSSF] does not have policies and procedures on the handling of requests from other NCAs. CSSF indicated that requests are quite rare (the number below was significantly affected by a specific request in the context of product intervention measures) and therefore they prefer to deal with such requests on an ad-hoc and tailored basis instead of adopting a specific procedure.<sup>58</sup>
166. The table below shows the number of requests received by each NCA from other NCAs in the review period in relation to firms' cross-border activities.<sup>59</sup> It also shows the average handling time of the requests and the number of requests that were still outstanding when the report was drafted, based on a self-assessment by the NCAs. The PRC notes that the

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<sup>58</sup> CSSF later indicated that they have procedures and policies for the handling of requests for cooperation, but that they cover a vast scope of areas (notably market abuse and fit & proper requests) and the cases at stake here concern only a small fraction of these requests. However, the PRC was not able to assess this as the relevant P&P have not been submitted to the PRC.

<sup>59</sup> For CySEC and MFSA – who are not assessed in their capacity as host, only requests received as home NCA are included. Other NCAs – except CNB - were not able to distinguish whether a request was received as home or host NCA or did not receive any such request in the review period.

MFSA was only able to provide complete information for the second half of the review period, while the numbers for the first half were retrieved on a best effort basis and could be higher.

**TABLE 11 – COOPERATION REQUESTS**

| NCA          | Number of requests received | Average time resolution | Number requests still outstanding |
|--------------|-----------------------------|-------------------------|-----------------------------------|
| <b>CySEC</b> | 372 (home only)             | Unknown                 | 12                                |
| <b>CSSF</b>  | 31                          | ≈1 month                | 0                                 |
| <b>BaFin</b> | 19                          | <1 month                | 1                                 |
| <b>CNB</b>   | 6 as home<br>8 as host      | ≈1 month                | 0                                 |
| <b>MFSA</b>  | 6* (home only)              | Unknown                 | 0                                 |
| <b>AFM</b>   | 2                           | ≈2 months               | 0                                 |

167. Regarding CySEC’s handling of requests, the PRC observed a significant number of cases in which it took CySEC considerable time to provide a response to the requesting NCA, and/or in which it did not send a response before or on the deadline as indicated by the requesting NCA. In addition, in many such instances, CySEC did not inform the requesting NCA well in advance of the inability to meet a given deadline. Moreover, in several instances, the response provided by CySEC after the deadline had passed only included questions for further information on the request.

168. HOME/HOST Making requests for consultation, cooperation, assistance or information to other NCAs. Four NCAs [AFM, BaFin, CySEC and MFSA] provided examples of a request made to another NCA in the review period. In these examples, the issue is explained, including the nature of the request. Where relevant, the related investor protection concerns are identified, and an initial assessment is made of the applicable MiFID II requirements and suspected violations by the firm at hand. The other two NCAs [CNB and CSSF] did not provide examples of requests made to another NCA in the review period.

169. Five NCAs [AFM, BaFin and CNB, CySEC and MFSA] have P&P for making requests to other NCAs. These cover both requests made in the home and host capacity. All such policies and procedures, except for those of the MFSA, contain provisions (e.g. a specific template to be used) to ensure that the request is precise and focused. One NCA [CSSF] does not have policies and procedures for making requests to other NCAs.

170. In addition to the above, the PRC discussed with NCAs about their practices to exchange with each other on a more general basis, beyond the context of specific requests or complaints. AFM and BaFin provided several examples as to how they strive to find opportunities for informal cooperation and more high level and regular exchanges to share views and intelligence with other NCAs, including in the context of ESMA’s Common Supervisory Actions.<sup>60</sup> The other NCAs indicated that they have started doing the same, although no example was provided.

<sup>60</sup> CySEC also provided some examples of more high-level exchanges with other NCAs that were outside the review period.

## Assessment

171. Cooperation between home and host NCAs is crucial to ensure effective supervision of firms' cross border activities. Both the home and host NCA have an important role to play: the home NCA being the competent authority, and the host NCA, being the one having in some cases valuable information needed to facilitate effective supervision by the home NCA.
172. Therefore, based on the supervisory expectations set out in the mandate, it is expected that host NCAs, where they have information (including complaints) on firms' cross-border activities in their jurisdiction, provide the information to the relevant home NCA in a clear, structured, coherent and secure manner. With regard to requests for consultation, cooperation, assistance or information, it is expected that NCAs make such requests in a precise and focused manner and handle them in a timely and satisfactory manner both when they act as home and as host NCAs.
173. HOST - Transmission by the host NCA of information, including complaints, on firms' cross border activities to the relevant home NCA. For AFM and BaFin, the PRC positively notes that the examples provided are clear, structured and coherent.
174. However, given the scarcity of examples provided, the PRC was unable to establish whether such information is systematically transmitted in a clear, structured, coherent and timely manner. Indeed, for CNB and CSSF, no examples could be provided to the PRC, thereby not making it possible to make such an assessment. Still, the CNB did provide evidence on examples outside the review period, which the PRC assessed as clear, structured and coherent.
175. Besides the specific examples (or the lack thereof), two of the NCAs reviewed [AFM and CSSF] do not have policies and procedures governing such transmissions. The PRC considers this as a shortcoming deserving mentioning.
176. HOME / HOST - Handling of request for consultation, cooperation, assistance or information from other NCAs. The PRC positively notes that five NCAs [AFM, BaFin, CNB, CySEC and MFSA] have policies and procedures that provide for an adequate handling of requests from other NCAs. However, it also notes that just two of these NCAs [CNB and CySEC] have guidance in place for the timely handling of requests from other NCAs. AFM also indicated having such guidance, but the document they referred to was unclear and included track changes. As timeliness is a crucial factor for ensuring an adequate handling of requests, the PRC views the omission of this aspect in the relevant policies and procedures as a shortcoming.
177. One NCA [CSSF] does not have policies and procedures on the handling of requests from other NCAs. The PRC considers this to be a shortcoming deserving mentioning.
178. As to the number of requests in relation to firms' cross-border activities received in the review period, the PRC notes that one NCA [CySEC] received by far most of the requests. The PRC considers this to be a sign of a high risk of potential investor detriment emanating from the activities of firms authorised by CySEC. Importantly, the PRC establishes that in many instances CySEC did not provide a timely response to a request from another NCA and in several instances, the response provided did not sufficiently answer the questions posed by the requesting NCA. Based on this, the PRC concludes that CySEC's handling of other NCAs' requests is not timely and satisfactory, and that CySEC's relevant policies



and procedure do not seem to be well implemented. The PRC recommends CySEC to devote substantially more resources to handling other NCAs' requests.

179. In terms of the average resolution time, the PRC observes substantial variation between NCAs. While, in principle, the PRC considers the average resolution time as an important indicator of the effectiveness of the NCAs' arrangements, the PRC also acknowledges that this figure might not be meaningful for those NCAs with a relatively low number of requests received. Indeed, in such cases, what should be considered as a reasonable average resolution time for the requests can be heavily influenced by a few complicated requests.
180. Still, an important observation is that two NCAs [CySEC and MFSA] were unable to provide statistics on the average handling time for the requests received. The PRC considers this as a substantial shortcoming as information on the average handling time is important information in monitoring the effectiveness of the NCA's arrangements. According to the PRC, this shortcoming is even more important in the case of CySEC, in light of the substantial number of requests received and thus the increased meaningfulness of such a figure in determining the effectiveness of the NCA's arrangements.
181. HOME / HOST - Making requests for consultation, cooperation, assistance or information to other NCAs. The PRC considers that the examples provided by four NCAs [AFM, BaFin, CySEC and MFSA] are positive as they are precise and focused.
182. The PRC also positively notes that four NCAs [AFM, BaFin and CNB and CySEC] have policies and procedures for making requests to other NCAs, aimed at making precise and focused requests. One NCA's [MFSA] policies and procedures do not include guidance on making precise and focused requests. Lastly, one NCA [CSSF] does not have such policies and procedures at all.
183. As the CSSF does not have policies and procedures and did not have examples of transmission of information / complaints as host authority and making of requests, the PRC could only assess the CSSF against the expectations on the handling of requests from other NCAs. The PRC recommends that CSSF develops policies and procedures (for incoming as well as outgoing requests) as an element to promote structural and consistent cooperation along the expectations set out by this peer review.
184. CNB could also not be assessed in respect to the expectation on sharing general information with home NCAs but was assessed in relation to other expectations in this section on the basis of the evidence provided.
185. In light of the above, the peer review assessment is as follows:
- a. In the role as home NCA
    - i. AFM: fully meeting expectations
    - ii. BaFin: fully meeting expectations
    - iii. CNB: fully meeting expectations
    - iv. CySEC: partially meeting expectations
    - v. CSSF: fully meeting expectations
    - vi. MFSA: largely meeting expectations

- b. In the role as host NCA
  - i. AFM: fully meeting expectations
  - ii. BaFin: fully meeting expectations
  - iii. CNB: fully meeting expectations
  - iv. CSSF: fully meeting expectations

186. In terms of good practices, the PRC notes that AFM proactively scouts opportunities, including in the context of Common Supervisory Actions launched by ESMA, to exchange views and intelligence on incoming / outgoing cross-border activities of firms with other NCAs at various levels of seniority. Other NCAs (e.g. BaFin, CNB) also indicated to do so, primarily with one NCA from neighbour jurisdictions.

#### 4.1.7 Enforcement and sanctioning

187. The PRC assessed whether home NCAs: (i) take enforcement / sanctioning measures<sup>61</sup> to prevent firms from continuing with an infringement, when they have clear grounds to believe that these may occur; and (ii) dedicate sufficient resources to these activities in respect to cross-border services. Further, the PRC assessed whether / how host NCAs: (i) cooperate in the enforcement and sanctioning activities by home NCA: and (ii) are able to apply precautionary measures under Article 86 MiFID II.

##### Summary of findings

188. The findings in this section consider actions in relation to firms active cross-border and breaches identified through supervisory actions related to cross-border activities. As indicated in other sections, the focus of NCAs' work was not found to be specific on cross-border activities, as such it may not be always clear cut to define whether a breach related to firms' cross-border activities or not. The PRC was mindful to the extent possible not to include in this section actions taken by NCAs on firms that may have a passport but appear not to be specifically or clearly related to firm's cross-border activities.

189. Enforcement actions on cross-border activities: The PRC looked at the enforcement / sanctioning measures<sup>62</sup> considered or taken in relation to alleged infringements identified in relation to firms' cross-border activities. Three NCAs [BaFin, CNB and CSSF] did not identify any such infringement in relation to cross-border activities in the review period and thus they did not take any related enforcement measures.<sup>63</sup> [AFM, CySEC and MFSA] did identify alleged infringements relevant to cross-border activities.<sup>64</sup> [AFM and CySEC] applied some enforcement measures in relation to these, while [MFSA] did not take any such measure specifically relevant to cross-border activities.

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<sup>61</sup> in accordance with Article 70 of MiFID II

<sup>62</sup> The peer review considered in this respect the formal measures that – following a breach from an authorised firms – the NCA took, which could be challenged and have formal consequences if not complied with (e.g. fines, incremental penalties, settlement, suspensions, etc.). Enforcement measures for the purpose of this section exclude supervisory actions such as requests for further information or simple requests for remediation reminders of regulatory requirements, etc.).

<sup>63</sup> The PRC considered for some cases whether some infringements on firms also active cross-border could be considered in this assessment but concluded that based on the information provided to the PRC, the cases identified could not be sufficiently considered to assess the use of enforcement by these NCAs in relation to cross-border activities.

<sup>64</sup> Exact number of infringements concerning cross-border activities not quantified.

190. From the investigations / inspections on firms' active cross-border<sup>65</sup> carried out, MFSA reported one case<sup>66</sup> where several subsequent supervisory and investigation activities between 2018 and 2020 on a firm having substantial cross-border activities lead to the identification of severe shortcomings in relation to the classification of clients served on a cross-border basis. MFSA requested the firm to engage in a third-party review and subsequently prepare a remedial action plan. MFSA faced challenges and delays from the firm / third-party reviewer and explored several different avenues to seek remediation by the firm. At the time of the on-site visit in July 2021, MFSA had not yet received the third-party review / firm's action plan, nor considered any enforcement action for this firm.<sup>67</sup>
191. AFM did identify alleged infringements relevant to cross-border activities<sup>68</sup> and took one measure in the review period<sup>69</sup>, notably the application of incremental penalties. In particular, AFM conducted several subsequent investigation activities on a firm with substantial cross-border activities, which spanned between 2017 and 2020.<sup>70</sup> AFM also received signals from host NCAs in relation to complaints on the firm's activity. The investigation of 2017 resulted in an incremental penalty (administrative penalty) in 2018, whereby AFM ordered the firm to solve 10 important breaches identified (organisational requirements, including safeguarding of client assets, acting honestly, fairly and professionally in accordance with the best interests of its clients, information disclosure to clients, etc.) within a given timeframe of 6 months. After the application of incremental penalties, the firm addressed most, but not all of the identified breaches.
192. CySEC identified 38 infringements (some of which for the same firm) regarding cross-border activities.<sup>71</sup> For 20 out of these, CySEC imposed four sanctions, concluded 16 settlements (for a total amount over 3 million EUR<sup>72</sup> for both sanctions and settlements). For two additional cases, following the commencement of an enforcement process by CySEC, the firms expressly renounced to the authorisation. 11 cases were closed without enforcement action despite that a violation had been identified.<sup>73</sup> Out of the 20 cases where enforcement / administrative measures were taken and of the cases where firms expressly renounced to the authorisation, over 50% related to firms to which at least another measure has been addressed in the previous or following years (sanction, settlement, suspension), often in relation to similar types of failures (e.g. failure to act honestly, fairly and professionally when providing investment services to clients; to provide fair clear and not misleading information to its clients or potential clients; other conduct of business obligations when providing investment and ancillary services to clients, etc.). At least one case of recurring settlement has also been identified. The PRC observed a case in which CySEC agreed to a settlement with a firm in the review period, while it had imposed a fine on this same firm few years before; this fine and settlement partially related to shortcomings in overlapping topics, such as the unauthorised provision of investment advice, not acting

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<sup>65</sup> Nine investigations / inspections on a total of seven firms.

<sup>66</sup> In addition to this case, in August 2020, MFSA withdrew the licence of a firm who had a passport to provide cross-border activities, but the breaches identified were not specifically linked to cross-border services or to an investigation looking into them.

<sup>67</sup> MFSA indicated that the fact that they have not taken enforcement action on identified infringements is without prejudice of the possible opening of future enforcement proceedings.

<sup>68</sup> Exact number of infringements concerning cross-border activities not quantified.

<sup>69</sup> Looking solely at measures taken as home authorities on firms authorised in NL in respect to their activities cross-border.

<sup>70</sup> AFM considers the complexity of this case as exceptional.

<sup>71</sup> CySEC identified 65 alleged infringements regarding cross-border activities which were presented to CySEC's board. From these, the CySEC's Board decided that there were infringements in 38 cases. CySEC also indicated that for some infringements identified in the review period the enforcement procedure was still open at the end of the review period.

<sup>72</sup> 3,031,000 EUR

<sup>73</sup> The sum of such examples is 33 instead of 38 as some cases were covered in a single decision by the CySEC Board.

in its clients' best interests, and fair, clear and not misleading information disclosure. CySEC also applied suspensions of authorisations in the review period. The examples analysed by the PRC include: (i) the case of a suspension for one month in which the firm was expected to remedy several important shortcomings which are at the heart of the client relationship in the provision of investment services<sup>74</sup>; and (ii) a case of a suspension for two weeks, due to important and numerous shortcomings<sup>75</sup>, including provision of investment advice without authorisation and also in relation to the firm having failed to take (or adequately inform CySEC of the same) sufficient corrective measures for the purpose of the settlement reached with the CySEC the previous year (the licence was subsequently suspended for an additional two months).

193. All NCAs apply specific criteria to determine whether to refer a matter for enforcement / sanction, driven by supervisory expert judgment and supported in some cases by specific scores / thresholds. NCAs indicated that enforcement is generally considered – among others - based on the severity of the alleged breach. Three NCAs [AFM, BaFin, and MFSA] suggested that they generally seek timely and effective remediation through supervisory measures / remedial action plans first and, if these prove unsuccessful, they consider enforcement / sanctioning measures. One NCA [CSSF] indicated that the enforcement decision matrix to assess the case and the opportunity to proceed with an enforcement decision is performed at the end of on-site inspections, as CSSF decides what actions to take based on the shortcomings observed.<sup>76</sup> Three NCAs [CNB, CSSF and CySEC] reported that their referral criteria do not include specific cross-border elements. Whilst the other NCAs [AFM, BaFin, MFSA] indicated that their referral criteria / process do consider cross-border elements<sup>77</sup>, the PRC notes that these elements are not spelled out in the relevant documents and the PRC could not identify practical examples where such criterion was considered.

194. Resources dedicated to enforcement<sup>78</sup>: [AFM, BaFin, CNB, CySEC and MFSA] indicated having between 2% and 12% of FTEs dedicated to enforcement activities for the

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<sup>74</sup>The shortcomings entailed: (i) acting honestly, fairly and professionally when providing investment services to clients, (ii) assessing the compatibility of the financial instruments with the needs of the clients to whom it provides investment services and to ensure that financial instruments are offered or recommended only when this is in the interest of the client, (iii) providing information, including marketing communications, to its clients or potential clients that is fair, clear and not misleading, (iv) providing appropriate information to clients in good time, (v) providing information in a comprehensible form.

<sup>75</sup> Provision of the investment service of investment advice, as a regular occupation, without the granting of prior authorisation by the CySEC, and due to failures to (i) comply at all times with the conditions for authorisation established in articles 17(2) and (6) of the Law, regarding the organisational requirements, (ii) take all reasonable steps to identify and to prevent or manage conflicts of interest between itself, including its managers, employees and tied agents, or any person directly or indirectly linked to it by control, and its clients, (iii) to act honestly, fairly and professionally when providing investment services to clients, in accordance with the best interests of its clients, (iv) to understand the financial instruments it offers or recommends, nor to assess the compatibility of the financial instruments with the needs of the clients to whom it provides investment services and does not seem to ensure that financial instruments are offered or recommended only when this is in the interest of the client, (v) to provide information, including marketing communications, to its clients or potential clients that is fair, clear and not misleading, (vi) to provide appropriate information to clients or potential clients in good time or in a comprehensible form, so that clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis, (vi) to ensure that natural persons giving information about financial instruments, investments or ancillary services, to clients on behalf of the Company, possess the necessary knowledge and competence, (vii) to ask the client to provide information regarding that person's knowledge and experience, so as to enable the Company to assess whether the investment service or product envisaged is appropriate for the client, (viii) to have given to the CySEC written notice of the change in the information relevant to a branch.

<sup>76</sup> E.g. whether to start non-contentious administrative proceedings (PANC), or to send an injunction letter or an observation letter. In case of a PANC proceeding, CSSF may re-run the enforcement decision matrix to assess the firm's response to the first PANC letter (e.g. the fact that actions have already been implemented by the firm constitute a mitigating factor which may influence the result of the matrix).

<sup>77</sup> For example, for BaFin it would be considered in the assessment of the criterion on the severity of the concrete violation

<sup>78</sup> These figures apply to all supervised entities. Clear estimates on the time dedicated to enforcement of cross-border activities could not be consistently retrieved across all NCAs in scope.

authorised firms.<sup>79</sup> CSSF could not provide a fixed figure since this depends on the occurrence or not of enforcement issues within the investment firms. Indeed, for all NCAs except CSSF there are dedicated staff working on enforcement activities. CySEC indicated that both staff from ongoing supervision and from the investigation and enforcement team work on enforcement activities.<sup>80</sup>

195. HOST – Cooperation in the enforcement and sanctioning activities by home NCA. Three NCAs [AFM, BaFin and CSSF] did not provide a specific example of a cooperation request as host NCAs in the context of enforcement actions by home NCAs.<sup>81</sup> One NCA [CNB] received a request for cooperation to gather information from supervisory activities / criminal proceedings against an investment firm. For all host NCAs, the practices / policies described in Section 4.1.6 above apply also in the context of cooperation under enforcement / sanctioning activities.

196. HOST – Application of precautionary measures under Art. 86. It is recalled that under MiFID II, supervision of cross-border activities provided through the FPS framework clearly rests with the home NCA. However, under Article 86 of MiFID II, where a host NCA has clear and demonstrable grounds for believing that an investment firm acting within its territory under the FPS framework infringes regulatory requirements, it shall refer those findings to the home NCA. If, despite the measures taken by the home NCA or because such measures prove inadequate, the investment firm persists in acting in a manner that is clearly prejudicial to the interests of host MS investors or the orderly functioning of markets, the host NCA can apply the so-called precautionary measures to, for example, prevent the firm from initiating any further transactions within their territories.

197. Two NCAs [CNB and CSSF] did not experience any situation in which they had clear and demonstrable grounds for believing that a firm acting within their territory under the freedom to provide services infringes its obligations under MiFID II and needed to apply as host precautionary measures under Art. 86 of MiFID II. Two NCAs [AFM and BaFin] experienced such cases but did not apply precautionary measures as host as, respectively, the relevant home NCA and the firm took action that (at least initially) addressed the matter.

## **Assessment**

198. Enforcement / sanctioning measures constitute an important supervisory instrument, to support NCAs' efforts in preventing firms from misconduct, ensuring that they put infringements to an end, that they are held responsible of detriment to investors and to ensure deterrence for other firms. While it is appreciated that enforcement is a lengthy and administratively heavy process, which may not be used for each and every infringement, NCAs should give consideration to this tool in their supervisory toolkit and use it effectively. Notably, as defined in the supervisory expectations set out in the mandate, home NCAs should take measures to prevent firms from continuing with infringements, when these are identified.<sup>82</sup> It is expected in this respect that a home NCA has taken or has at least considered some form of enforcement or administrative sanctions against infringements identified in the sample period in respect of cross-border activities. Furthermore, resources dedicated to enforcement activities on cross-border services should be sufficient.

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<sup>79</sup> total FTEs dedicated to enforcement / number of authorised firms

<sup>80</sup> Other NCAs also indicated that staff primarily dedicated to enforcement often seek collaboration with other supervisory staff.

<sup>81</sup> BaFIN indicated that they could not identify any such request.

<sup>82</sup> Reference is made to administrative sanctions and measures imposed pursuant to Article 70 of MiFID II

199. For BaFin, CNB and CSSF, while they provided some information on their overall approach to enforcement, including how they may – or may not – consider cross-border elements in the prioritisation of cases – the PRC considers – based on the lack of relevant examples as raised above - that it is lacking elements to perform a relevant assessment against the expectations. The PRC notes that the fact that no alleged infringements were identified specifically in relation to cross-border activities in a two-year review period links closely to the limited supervisory focus on cross-border activities observed in previous sections and invites these NCAs to consider the risk that violations specifically linked to firms' cross-border activities may remain undetected or unaddressed.
200. MFSA did not consider enforcement / sanctioning measures against identified breaches related to cross-border activities in the review period. The NCA experienced a case where severe shortcomings were observed, for which they proceeded with requesting remediation from firms, and had to engage in repeated subsequent requests to ensure effective remediation, with several shortcomings remaining outstanding for long after the investigations concluded. The PRC is concerned that MFSA has not made effective use of an important supervisory tool in the context of cross-border supervision, with the consequence of a firm providing services to investors cross-border while affected by severe and longstanding shortcomings leading to a sustained risk of investor detriment. Furthermore, limited enforcement creates limited deterrence, if firms learn that they can remediate breaches without consequences. While the PRC appreciates that enforcement is a lengthy process, and notes that MFSA developed referral / prioritisation criteria, it considers that they should neither (i) put the bar to use enforcement on cross-border services too high, effectively meaning that they only exceptionally use it, or (ii) consider it only as subsequent to other supervisory actions if they prove ineffective rather than as a complementary tool.
201. AFM considered and applied enforcement measures (incremental payments) in one case where ten serious breaches related to cross-border activities were identified. In this context, the firm put to an end the great majority of infringements. The PRC notes that while AFM indicated a preference to first address shortcomings to supervisory actions before considering enforcement measures, they took stronger action (incremental payments) for this firm upfront. The PRC finds that this is broadly aligned to the expectation that NCAs consider enforcement measure to effectively put infringements to an end. At the same time, the PRC notes that the measure taken was relatively soft and not effective on a small subset of the breaches identified. The PRC considers that AFM would benefit from considering stronger early-stage enforcement and sanctioning measures more systematically in relation to cross border supervision. Indeed, limited enforcement creates limited deterrence, if firms learn that they can remediate breaches without consequences.
202. Furthermore, the PRC considers that, in absence of formal criteria clearly defining how cross-border elements are considered in the referral of a case to enforcement (e.g. as part of severity of the case), NCAs should reflect as to whether the current criteria adequately and clearly take into account infringements in relation to cross-border activities (for instance, if the NCA considers that an aggravating factor is that the infringement is carried out in several jurisdictions), so to ensure that these cases are referred for enforcement and prioritised consistently to other cases (i.e. not de-prioritised to alleged infringements affecting predominantly domestic investors). Finally, the PRC could not assess the adequacy of resources dedicated to the enforcement of cross-border activities, given the limited proceedings undertaken.

203. In light of all above considerations, AFM is assessed as largely meeting expectations, and MFSA is assessed as partially meeting expectations.

204. With regard to CySEC, the PRC positively notes that enforcement actions were considered and taken, including involving amounts for sanctions and settlements which, in absolute terms, are not negligible. At the same time, among all infringements identified in the review period, only some were followed by enforcement measures. Other cases of infringements were closed with no formal enforcement action and dealt with some informal supervisory measures only. Importantly, many of the firms on which enforcement actions were taken in the review period committed recurrent severe and - at times - similar breaches. As noted in previous sections, several of the shortcomings identified by CySEC suggest structural behavioural and organisational deficiencies in the firms at stake. In the sample of suspensions looked at, it is also noted that CySEC applied suspensions for a fairly limited duration (2-4 weeks) to remediate several serious and structural shortcomings. Moreover, the PRC observed instances of CySEC imposing a fine on a firm and subsequently, within a relatively short time period, agreeing to a settlement with the same firm, or, again agreeing to a settlement, both relating to severe shortcomings on partially overlapping topics. Enforcement actions need to be effective in putting the infringement to an end (with structural, objective and not cosmetic remediation) and in having a clear deterrence effect for the firm in question and for peers. In light of the above considerations, the PRC is concerned that the enforcement actions taken by CySEC were – as a whole – not commensurate, in terms of timeliness and materiality - to the risks posed by firms' cross-border services and the actual or potential detriment that they pose and, as such, not effective in preventing the firms from continuing with their infringement. CySEC is therefore assessed as partially meeting expectations.<sup>83</sup>

205. To summarise, the peer review assessment of NCAs in their home authority role is as follows:

- a. AFM: largely meeting expectations
- b. BaFin: not assessed
- c. CNB: not assessed
- d. CSSF: not assessed
- e. CySEC: partially meeting expectations
- f. MFSA: partially meeting expectations

206. With regard to host NCAs, as defined in the supervisory expectations set out in the mandate, they should cooperate in a clear, structured and coherent manner in the enforcement and sanctioning activities by the home NCAs in relation to services provided within the host NCA's territory. Furthermore, if the host NCAs have clear and demonstrable grounds for believing that a firm acting within their territory under the freedom to provide

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<sup>83</sup> The PRC also notes that the observed use of enforcement may in part stem for the more intense supervisory activities in 2015-2018 driven cooperation efforts between CySEC and other NCAs, in the context of a Joint Group set up under ESMA's chairmanship. This Joint Group was established to cooperate in relation to Cyprus-based investment firms operating in other jurisdictions in FPS and raising significant investor protection concerns. The Joint Group was closed in July 2018 (i.e. right before the start of the peer review period covered by this peer review). The current PRC assessment is assuming that the enforcement activities observed in the peer review period, correspond to CySEC regular standards and not to an above-average use of enforcement as late result of the Joint Group's work.

services infringes its obligations under MiFID II, they should be, ultimately, able to apply precautionary measures under Art. 86 of MiFID II.

207. As CSSF did not receive any cooperation request in the context of enforcement procedures and did not experience any situation in which precautionary measures needed to apply, the PRC cannot assess them in respect of their role as host in relation to the enforcement area. CNB could not be assessed in relation to the expectation on the application of precautionary measures, given the lack of cases where they considered having the requested evidence to take these actions.

208. For AFM, BaFin and CNB, the same observations raised in Section 4.1.6 apply to NCAs' cooperation as host authority in the context of enforcement. As regards the application of precautionary measures, the PRC positively notes that AFM and BaFin – when they considered having clear and demonstrable grounds of possible infringements in the activities carried out in their MS, took forward the matter with the home NCAs that took actions to address the issue, or informal actions with the firms, not finding themselves in the need to apply precautionary measures as host.<sup>84</sup>

209. In light of the above, the peer review assessment of NCAs in their host authority role is as follows:

- a. AFM: fully meeting expectations
- b. BaFin: fully meeting expectations
- c. CNB: fully meeting expectations
- d. CSSF: not assessed

## 4.2 Assessment and recommendations tables

210. The following tables set out the peer review's assessment grade for each NCA under the areas assessed. In each case, NCAs are assessed as fully compliant, largely compliant, partially compliant or non-compliant. The assessment is reflected in two different tables as the first table relates to the assessment of expectations on home NCAs, whilst the second table relates to the host-aspects assessment.

**TABLE 12 – ASSESSMENT OF NCAS - HOME**

|   | AFM | BaFin        | CNB | CSSF | CySEC | MFSA |
|---|-----|--------------|-----|------|-------|------|
| <b>Authorisations activities</b>            |     |              |     |      |       |      |
| <b>Processing of passport notifications</b> |     |              |     |      |       |      |
| <b>Arrangements for ongoing supervision</b> |     |              |     |      |       |      |
| <b>Day to day supervision</b>               |     |              |     |      |       |      |
| <b>Investigations and inspections</b>       |     |              |     |      |       |      |
| <b>Cooperation and exchanges with NCAs</b>  |     |              |     |      |       |      |
| <b>Enforcement and sanctioning</b>          |     | Not assessed |     |      |       |      |

<sup>84</sup> Additional considerations on this point are raised in Section 4.4.2



**TABLE 13 – ASSESSMENT OF NCAS - HOST**

|                                      | AFM | BaFin | CNB | CSSF         |
|--------------------------------------|-----|-------|-----|--------------|
| Processing of passport notifications |     |       |     | Not assessed |
| Cooperation and exchanges with NCAs  |     |       |     |              |
| Enforcement and sanctioning          |     |       |     | Not assessed |

|                            |                              |                                |                          |
|----------------------------|------------------------------|--------------------------------|--------------------------|
| Fully meeting expectations | Largely meeting expectations | Partially meeting expectations | Not meeting expectations |
|----------------------------|------------------------------|--------------------------------|--------------------------|

#### 4.2.1 Recommendations by the PRC

211. As foreseen in Article 30 of ESMA Regulation, the table below includes the recommendations made by the PRC to address weaknesses identified in the peer review. Recommendations subject to a follow-up<sup>85</sup> two years from the publication of this report are marked as such.

212. As noted in Section 4.2.2, the PRC also identifies cross-cutting recommendations for possible supervisory convergence initiatives, such as to facilitate NCAs' access to and exchange of information including through data collection on actual cross-border activities and improving NCAs' assessment and understanding of cross-border related risks, which may be support NCAs in addressing some of the recommendations below. In this context, practical arrangements among home / host NCAs (such as for examples through delegation of tasks) may also be explored.

**TABLE 14 – RECOMMENDATIONS**

| Topic                                | NCA / Recommendation   | Follow up   |
|--------------------------------------|--|---|
| <b>Transversal (CY)<sup>86</sup></b> | <p>CY – In light of the issues observed in the peer review, CySEC should increase the resources directly dedicated<sup>87</sup> to the entire supervisory cycle (authorisations, ongoing supervision and enforcement) of the peer-reviewed activities, to be closer to the average ratio of supervisory FTEs per supervised firms observed in the referenced peer review. This means that CySEC should enlarge its supervisory teams with around 30-40 new members.<sup>88</sup></p> <p>Since firms can still provide activities while new supervisory resources are recruited, CySEC should endeavour to conclude the resources increase in a reasonable amount of time and implement interim solutions, including by</p> | <p>Y</p> <p>Follow up under Article 16 of ESMAR</p> |

<sup>85</sup> under article 16 of ESMAR and the Methodology

<sup>86</sup> The recommendations in the "Transversal (CY)" rows refer to "peer reviewed activities" as the cross-border activities targeting retail clients carried out under the freedom to provide investment services and activities in accordance with Article 34 of MiFID II

<sup>87</sup> i.e. not including support staff

<sup>88</sup> considering that almost the totality of firms supervised by CySEC at the time of this peer review has notified to CySEC a passport to operate cross-border

|  |  |   |
|--|--|---|
|  | <p>considering the possibility to temporarily use staff from other non-strategic or less risky areas to strengthen this key area of CySEC supervision.</p> <p>This recommendation is made in accordance with Article 16 of the ESMA Regulation. For the purpose of this, CySEC should provide to ESMA a plan to implement the recommendation, including the timeline for the gradual recruitment of resources and the interim solution identified.</p>   |   |
|  | <p>CY – Put in place a revised annual supervisory plan, spanning ongoing supervision, investigations and – as applicable – enforcement, to increase the supervisory work performed on firms’ providing the peer-reviewed activities and aiming to improve the effectiveness of CySEC’s supervision in addressing supervisory risks at an earlier stage and responding more forcefully to problems identified. In particular, this supervisory plan should lay down a concrete strategy on firms’ peer-reviewed activities aimed at ensuring (i) intense supervision of all High and Medium-High risk firms carrying out those activities, as classified by CySEC, and (ii) sustainably compliant behaviour by the firms, with an increased focus on those firms perceived as particularly problematic, which could, where necessary, involve removing the authorisation of firms exhibiting aggressive behaviours.</p> <p>The outcome of such a plan should result in taking or requesting, in a timely way, actions commensurate to the nature and scale of risks, problems and shortcomings identified, to effectively prevent, mitigate or bring them to an end (including by taking measures - vis-à-vis firms and individuals - whose severity considers the repetition or continuation over time as aggravating factors).</p> <p>The effectiveness of such a plan should be assessed over time against, inter alia, the following indicators in relation to firms’ peer reviewed activities: (i) the number of complaints<sup>89</sup> is significantly reduced; (ii) the number of requests received from host NCAs is significantly reduced; (iii) measures are taken taking into account the repetition or continuation over time as aggravating factors; (iv) remedial actions required from firms are effectively overseen by CySEC, not only based</p> | <p>Y</p> <p>Follow up under Article 16 of ESMAR</p> |

<sup>89</sup> Considering the total numbers of the following types of complaints: (i) complaints received by CySEC from host NCAs; (ii) complaints received by CySEC from stakeholders (e.g. clients, investors associations, financial ombudsman etc.) other than host NCAs; and (iii) complaints received directly by supervised firms.

|                         |   |   |
|-------------------------|---|---|
|                         | <p>on observations from the firm's internal or external auditor, but also based on own observations (e.g. review of revised firms' files and agreements with third parties/clients, actual samples, follow-up on-site visits).</p> <p>This recommendation is made in accordance with Article 16 of the ESMA Regulation. For the purpose of this, CySEC should provide to ESMA a plan to implement the recommendation and periodic statistics on the above indicators.</p> |   |
| <b>Transversal (MT)</b> | <p>MT - Monitor closely the growth in authorisation applications and supervised firms active cross-border and identify in a timely manner any need to scale up or adjust related supervisory practices and resources. In making this assessment, the PRC recommends MFSA to closely monitor, among others, the complaints received and the requests made by host NCAs.</p>  |   |
| <b>Authorisations</b>   | <p>CZ, DE, LU, NL - Introduce targeted criteria and controls<sup>90</sup> at authorisation stage to assess information in relation to firm's intentions to perform cross-border activities assessing the overall structure and capability of the applicant firms' proposed governance and risk management structures and processes to operate in other MS.</p>  | Y |
|                         | <p>MT – Complete the existing authorisation controls for cross-border activities by including controls in relation to the foreign languages in which cross-border activity may be carried out, and in particular whether internal control functions have capacity and processes to oversee the information provided to clients in local languages. Ensure that these controls are systematically and thoroughly conducted at authorisation stage.</p>                     |   |
|                         | <p>CY - Complete the existing authorisation controls for cross-border activities by including controls on whether the firm's organisation is adequate to carry out the cross-border activities envisaged, including in particular whether internal functions have capacity and procedures to process and oversee the information provided to clients and by clients in</p>  | Y |

<sup>90</sup> including controls on firm's arrangements and organisation with regard to the cross-border activities to be undertaken, the support structures available to the control functions to mitigate the additional risks to which the firm may be exposed due to its cross-border activities, whether the firm will be outsourcing any part of its activities in any host member state, controls in relation to the foreign languages in which cross-border activity may be carried out, and in particular whether internal control functions have capacity and processes to oversee the information provided to clients in local languages

|  |   |   |
|--|---|---|
|  | local languages. These controls should take into account the prominence of cross-border activities for firms authorised in Cyprus. Ensure that these controls and assessments are systematically and thoroughly conducted at authorisation stage.   |   |
| <b>Supervisory activities (including arrangements for ongoing supervision, day to day supervision and use of investigations / inspections<sup>91</sup></b> | CY, CZ, DE, LU, MT, NL – Ensure that the approach to supervision of cross-border activities by firms specifically take into account and address the risks linked to the nature, scale and complexity of the activities firms carried out in other MS. This should, as a minimum, include <ul style="list-style-type: none"> <li>• collecting on a regular basis information on firms’ actual cross-border activities with respect to all relevant aspects as identified in the peer review mandate (i.e. the jurisdictions in which the services are provided, the type(s) and number of clients involved and the type(s) of activities and services provided and instruments used) and making the data collected readily available to staff in charge of firms’ supervision;</li> <li>• taking into account cross-border specific risks in the risk-based approach / models used for supervision;<sup>92</sup></li> <li>• developing – as needed - clear guidance to staff carrying out supervisory activities.</li> </ul> | Y |
|  | CY, CZ, DE, LU, MT, NL – Beyond the data collection mentioned above, put in place regular specific monitoring activities <sup>93</sup> on the overall cross-border activities of firms and their relevant risks, based on the nature, scale and complexity of the activities provided. Such activities should be able to capture specific risks or potential issues arising   | Y |

<sup>91</sup> When defining how to implement the recommendations in this section, CySEC may consider how these interact with those made under Article 16 above and take them in a combined manner.

<sup>92</sup> MFSA has already broadly met this point but should ensure to use information on a firm’s actual cross-border activities, not a firm’s formal passporting notifications, to contribute to the assessment of the firm’s risk score.

<sup>93</sup> To monitor: (i) the overall cross-border activities of authorised firms and their relevant risks, including the firms’ organisation (e.g. marketing strategy, marketing means including the use of digitalisation, use of tied agents/third parties, reasons for place of establishment), conduct and performance (e.g. firms’ notifications, market news, external stakeholders information – e.g. possible concerns on specific complex and/or risky products - and information received from host NCAs on a firm’s activities in their jurisdictions - e.g. possible concerns about aggressive sales or marketing techniques of a firm, or offering of high-risk products / operations). The extent, frequency and proactiveness of these monitoring activities is based on the nature, scale and complexity of the activities / services provided, including the types of clients of the firm. (ii) The complaints (both firm-specific or on similar business models or products) received directly or from host NCAs. A strategy for prioritisation may be necessary depending on the number of complaints received.

|  |   |                   |
|--|---|-------------------|
|  | <p>from firms' cross-border activities (e.g. monitoring of foreign language websites or marketing communications).</p> <p>As part of this reinforced supervisory framework on cross-border activities to be established, use available supervisory tools including intrusive tools such as investigations and inspections to assess firms' cross-border activities, when relevant to the scale, nature and complexity of the cross-border activities. This would include, but not be limited to, when performing investigations / inspections on overall firms' activities, ensuring adequate representation of firms providing cross-border activities in the sample of firms selected and/or through samples relating to firms' cross-border activities (e.g. selection of files of foreign clients) based on their nature, scale and complexity.</p> |                   |
|  | DE – Scale up supervisory activities carried out by BaFin's staff in order to have an adequate view of the characteristics and risks posed by firms' cross-border activities, based on BaFin's own observations beyond what is covered by the annual auditors' review.  | Y                 |
| <b>Cooperation and exchanges with NCAs</b> | <p>CY, LU, NL - Reinforce the framework for cooperation with other NCAs in the context of cross-border supervision by:</p> <p>(i) monitoring (e.g. by retaining easily accessible statistics) the average handling time for requests received to be able to assess whether such requests are handled in a timely manner and take action as needed (CY and LU);</p> <p>(ii) developing policies and procedures on the transmission of information, including complaints, to home NCAs, aimed at providing information that is clear, structured and coherent (NL and LU);</p> <p>(iii) developing policies and procedures on the handling and making of requests from and to other NCAs (LU).</p>  | Y (for point (i)) |
| <b>Enforcement and sanctioning</b>         | CY, CZ, DE, LU, MT, NL <sup>94</sup> – Assess the framework for enforcement (frequency, type of measures, level of sanctions / settlements and timeliness) in relation to cross-border activities and identify and implement relevant changes in order to use this tool to effectively prevent firms from   | Y                 |

<sup>94</sup> While the peer review does not conclude on the benchmarks for CNB, CSSF and BaFin, the PRC considers this recommendation to be valid also for these NCAs in that, as they scale out the supervisory work on cross-border activities, they should assess the use of enforcement therein in accordance with this recommendation.

|  |   |   |
|--|---|---|
|  | <p>continuing with infringements. It is expected that by the time the follow up will be conducted, NCAs will have applied or at least considered enforcement measures in relation to infringements identified in firms' cross-border activities.</p>  |   |
|  | <p>CY<sup>95</sup> – establish a system to monitor and assess the recurrence of breaches by firms conducting cross-border activities and identify and introduce relevant changes in the enforcement measures applied (e.g. type of measure, level of sanctions and / or timeliness) in order to act as a real deterrent to breaches by firms.</p> | Y |

#### 4.2.2 Cross-cutting issues and recommendations

213. The PRC identified cross-cutting issues in relation to supervision of cross-border activities by firms. As foreseen by the methodology, possible issues of independence in the degree of independence by NCAs were also considered.

214. Regarding the independence of NCAs, concerns were raised on the adequacy of supervisory resources of CySEC. During the onsite visit, CySEC shared these concerns and the challenges in negotiating with the Ministry of Finance and in obtaining additional budgetary / resources conditions. CySEC also noted that even after additional resources are approved, substantial time is needed to launch, perform and conclude the recruitment process. Indeed, shortcomings on the adequacy of supervision under MiFID II by CySEC were already raised in the peer review on certain aspects of the compliance function under MiFID I (report November 2017, thereafter “the compliance function PR”).<sup>96</sup>

215. In this context, the PRC would like to raise that the adequacy of resources of an NCA is not only relevant to its supervisory effectiveness, but also to its independence. Notably, as a matter of principle, in order to be independent, NCAs need to have adequate stable funding and the ability to use it to fulfil their mission. Indeed, supervisory effectiveness is reliant on financial independence to ensure operational independence and adequate staffing and training.

216. CySEC indicated that they enjoy a substantial degree of budgetary independence, in that their annual budget is funded by own generated funds (through industry fees which are determined exclusively by CySEC) and a pre-agreed fixed sum through the National Budget (Ministry of Finance). While the PRC appreciates that this dual budget can increase CySEC's independence and ability to increase resources, the PRC is also mindful of the repeated observations raised by CySEC's staff during the on-site visits, in terms of challenging negotiation with the Ministry of Finance in order to obtain new resources, as

<sup>95</sup> When defining how to implement the recommendations in this section, CySEC may consider how these interact with those made under Article 16 above and take them in a combined manner.

<sup>96</sup> CySEC indicated that following this, it obtained from the Ministry of Finance additional resources, but that given the timing of recruitment processes – as also lengthened by the Covid-19 situations – these resources had not yet joined CySEC at the time of the onsite visit in June 2021. CySEC informed the PRC in November 2021 that these resources had eventually joined in October 2021.

well as by the substantial amount of time that CySEC needed in practice to increase supervisory resources following the 2017 compliance function peer review. The PRC invites CySEC to consider the findings in terms of adequacy of resources, also from the perspective of ensuring their effective independence at all times.

217. The PRC notes that ESMA is considering the independence of NCAs as part of a separate and more focused exercise.<sup>97</sup>
218. From a separate standpoint, also regarding the independence of NCAs, the PRC positively notes that CNB established a mandatory rotation mechanism for supervisors not to be in charge of supervision of the same firm for too long.
219. Regarding cooperation among NCAs, the PRC notes that most NCAs tend to exchange on outgoing / incoming cross-border activities in the context of specific complaints, or firm-specific suspicions. The PRC also noted that at times home NCAs indicated receiving a wide range of complaints and signals from host NCAs in a possibly unstructured and repetitive manner. The PRC considers that host NCAs may have an important role in supporting home NCAs' supervision of cross-border issues, by providing information and intelligence on activities carried out in their territory by non-domestic firms, when they come to the host NCAs' attention. In this context, NCAs, when acting in their role as host authorities, are reminded of the importance to provide home NCAs with clear, structured and precise information to support home NCAs' supervisory activities. Furthermore, there appears to be room to improve and strengthen interaction among NCAs, creating opportunities to exchange views, information, intelligence and assessment on specific firms, products or risks, beyond the occasions generated by specific complaints. This could increase home NCAs' knowledge of markets where their firms are active, facilitate finding relevant solutions and possibly ease the burden of written communication. ESMA may consider facilitating these exchange opportunities. In this context, practical arrangements among home / host NCAs (such as for examples through delegation of tasks) may also be explored.
220. In relation to the above, the PRC indeed stresses the importance that NCAs effectively communicate to make use of information available to each other. It is noted that a supervisory convergence initiative is underway in the context of Article 31a of ESMAR, whereby ESMA, together with the European Banking Authority and with the European Insurance and Occupational Pensions Authority, is expected to establish a system for the exchange of information relevant to the assessment of the fitness and propriety of holders of qualifying holdings, directors and key function holders of financial market participant by competent authorities. The PRC also understands that ESMA may explore the use of IT tools for the secure exchange of confidential information, noting the importance that NCAs are able to exchange relevant information in a secure manner.
221. Regarding NCAs' awareness of actual cross-border activities from authorised firms, it is noted that ESMA organised in September – October 2020 an exercise (repeated in 2021) by which NCAs collected on a voluntary basis through a reporting template data on entities' cross-border activity. The NCAs covered by this peer review concurred that the exercise significantly supported their awareness of whether firms holding a passport were actually

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<sup>97</sup> See report [https://www.esma.europa.eu/sites/default/files/library/esma42-110-3265\\_report\\_on\\_ncas\\_independence.pdf](https://www.esma.europa.eu/sites/default/files/library/esma42-110-3265_report_on_ncas_independence.pdf). It is noted that in the context of the ESMA report on NCAs' independence, CySEC did not raise issues with the sufficiency of their human resources.

active and to what extent, as some of the NCAs only started collecting this information in the context of the ESMA exercise. ESMA may consider continuing promoting and formalising this exercise to support NCAs' ability to monitor firms' cross-border activities.

222. Regarding NCAs' risk assessment, the PRC noted that almost no NCA reflects the nature, scale and complexity of the cross-border component in the risk assessment of firms. While this may be considered as part of the overall firm's risk assessment, the cross-border dimension of firms is expected to continue growing and it would be crucial to further reflect it in NCAs' risk assessment. ESMA may facilitate exchange among NCAs on their risk assessment frameworks in this respect.
223. Regarding processing of passport notifications, NCAs are broadly split in two: those checking only that a passport notification contains the required information under Art 34 of MiFID II, and those assessing whether there are supervisory constraints suggesting that the firm is not ready / fit to operate cross-border. In both cases, however, NCAs noted that MiFID II does not formally allow NCAs to hold / stop sending passport notifications in case of concerns. The PRC considers it important that firms active cross-border are adequately structured and organised to do so. The recommendations identified by the PRC in the previous section aim to strengthen such controls in NCAs' authorisation and supervisory activities, including to ensure that the cross-border dimension of activities is captured in the supervision of firms from the moment it is notified. The implementation of these recommendations is expected to improve (assurance on) firms' readiness to operate cross-border both for NCAs that apply a more formal approach to passport notifications and those that carry out additional controls at this stage.
224. In relation to the above, the PRC considered in their review whether for firms that did not indicate cross border plans at authorisation phase, there were cases in which the decision to start operating cross border and notify a passport resulted in a notification of material changes under Article 21(2) of MiFID II. The PRC considers that there could be indeed some cases where the decision to provide services in other MS needs to be accompanied by a substantial reorganisation of the firm qualifying as a material change to the initial set-up of the firm at the point of initial authorisation.<sup>98</sup> As firms should undergo extensive scrutiny at authorisation stage, when they declare the intention to provide cross-border activities, in order to ensure that they are well organised to undertake such activities it may be relevant to replicate the same level of scrutiny in those cases where the start of cross-border activities is accompanied by substantial organisational changes that would make the initial authorisation assessment as no longer relevant. Further reflections on this matter among NCAs may be useful.
225. Regarding the regulatory framework, it is noted that under Art 86 of MiFID II, host NCAs may apply precautionary measures in case of cross-border activities being carried out in their jurisdiction in prejudice to investors' interest and ineffective measures being taken by the home NCA. To do so, the host NCA needs to have clear and demonstrable grounds for believing that firm is in infringement of relevant obligations. As host NCAs do not have direct supervisory powers, the PRC notes that the ability of the authorities to obtain this standard of proof may be unattainable, thereby impairing the ability of host NCAs to actually

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<sup>98</sup> This could be the case for instance of a firm authorised many years before the decision to commence cross-border activities, previously operating locally and then deciding to actively and substantially market services in other MS.



use these powers. The PRC notes that ESMA has already made proposals to this end to the European Commission.

226. Finally, the PRC engaged with stakeholders such as investors associations (including active at European level), investment service providers, and external auditors. This engagement allowed a better understanding of the operation of the cross-border provision of services from such stakeholders' perspective, considering both the home and host standpoint, and of the supervisory practices in place. Inputs from this engagement are reflected already in the above assessment. On the side of investors, it was noted that on some occasions, firms active cross-border use more aggressive marketing practices than those primarily targeting the domestic markets. It was also noted that it is often unclear to investors in a given jurisdiction that their domestic NCA is not the responsible authority for some activities carried out in their territory, causing questions on how to address relevant complaints.

### 4.3 Good Practices

227. The PRC identified good practices with regard to NCAs' supervision of cross-border activities of investment firms and credit institutions as presented in the table below.

**TABLE 15 – GOOD PRACTICES**

| <b>Topic</b>                                | <b>Good Practices identified by the PRC in relation to NCAs</b>   |
|---|---|
| <b>Organisational Background</b>            | Rotation mechanisms for supervisors not to be in charge of supervision of the same firm for too long  |
| <b>Authorisations</b>                       | Asking applicant firms for a self-declaration on previous supervisory history or applications, so to support the NCA in conducting relevant controls, including with other NCAs   |
| <b>Passport notifications</b>               | Proactively informing firms that the passport notification has been submitted to the relevant host NCA(s), so to help ensuring that the firm does not commence activity in the host MS until the relevant NCA has been notified |
|   | Consider - when processing passport notifications - the supervisory information available for the firm at stake (e.g. by using a dedicated checklist  |
| <b>Arrangements for ongoing supervision</b> | Collecting information on firms' actual cross-border activities on a quarterly basis  |
|   | Collecting information on investment firms' revenues generated per MS   |
| <b>Day to day supervision</b>               | Conducting post-authorisations onsite visits (around 6-12 months) after the firm has been authorised / has commenced its activities, to take stock of how the firm is operating compared to the authorisation application       |
|   | Use of a dedicated tool to monitor firms' social media activities   |



|  |  |
|--|--|
| <b>Cooperation<br/>and<br/>exchanges<br/>with NCAs</b> | Proactively scouting opportunities to exchange views and intelligence on incoming / outgoing cross-border activities of firms with other NCAs at different levels of seniority |
|--|--|

## Annex 1 - Mandate



ESMA42-111-5043  
Peer Review supervisi

## Annex 2 - Questionnaire



ESMA42-111-5456  
PR Cross Border Activ

## Annex 3 - Statement from NCAs

An on-site visited NCA may submit a written statement to be annexed to the peer review report. One NCA, CySEC, has issued a statement on the outcome of the peer review report, which is reproduced below.

### Statement by CySEC

*CySEC would like to express its appreciation for the intense efforts and the work undertaken by the Peer Review Committee (PRC) in performing this very important Peer Review.*

*CySEC also confirms its unwavering commitment to ensuring that investors across the EU are adequately protected and has thus made this its overarching priority and has hence welcomed the launching of the Peer Review on NCA's supervision of cross-border activities of investment firms.*

*Fully cognizant of the challenges presented by the fast paced developments in the digitalisation of financial services which provides retail investors with easy access to an increasing number of financial products which they never had before and which they may not be able to understand or fully comprehend the inherent risks of, CySEC has intensified its efforts to supervise firms with cross-border services and drive better understanding among investors of potential risks. In the last 18 months, CySEC has implemented important changes, including to increase its staff by 28%<sup>99</sup> and continues to invest in technology aiming to further strengthen its supervisory infrastructure<sup>100</sup>. Meanwhile measures/penalties of increasingly dissuasive*

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<sup>99</sup> Specifically in October 2021 the permanent CySEC staff was increased by 32 new employees of which 15 (constituting a 44% increase) have been placed in supervisory duties including for MiFID firms. Of note is the fact that the recruitment process for at least another 13 staff is to be concluded by mid-2023, while 9 more officers are expected to be hired in early 2024.

<sup>100</sup> This includes the acquisition of a powerful custom-made online supervisory tool which will enhance CySEC's ability to monitor the on-line marketing communications of CIFs and spot problematic conduct early on, including



*nature (including withdrawal of licenses) continue to being applied in cases non-compliance is found.*

*Therefore, CySEC has already taken decisive steps which are also in line with the PRC's recommendations. Nevertheless, CySEC is ready and committed to make every effort in fully implementing all PRC's recommendations and in finding the most appropriate, efficient and effective ways to further enhance supervision and investor protection in the cross-border provision of financial services in this "digitalization era", in line with the Report.*

*Fully respecting the Peer Review Methodology and the findings of the PRC, CySEC considers that certain sections of the report could have more accurately reflected the actions and work undertaken by CySEC<sup>101</sup>, including in comparison to its peers. For instance, the fact that the information collected regarding the firm's actual cross border activities is used in its supervision, the fact that the thematology covered by the reviews performed by CySEC included fundamental issues and not just niche ones, and the, in many instances, extensive correspondence with requesting NCAs in the execution of their requests. It would seem that the virtual nature of the on-site visit might not have allowed the usual personal interactions supporting in-depth discussions and follow-up where deemed necessary, in response to the PRC's requests, as would have been, had the on-site been a physical one.*

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persistent and or aggressive advertising. Other key supervisory infrastructure projects aimed at proactively identifying and tackling potentially problem areas, include CySEC's Enterprise Risk Management Framework, a Data Governance Framework, an upgrade of the Risk-Based Supervision Framework and the expansion of the CySEC continuous professional training programme, which will compel all persons who are in direct contact with retail customers to be registered and comply with formal CPD requirements.

<sup>101</sup> More specifically relating to arrangements for ongoing supervision, day to day supervision, and the cooperation and exchange of information.