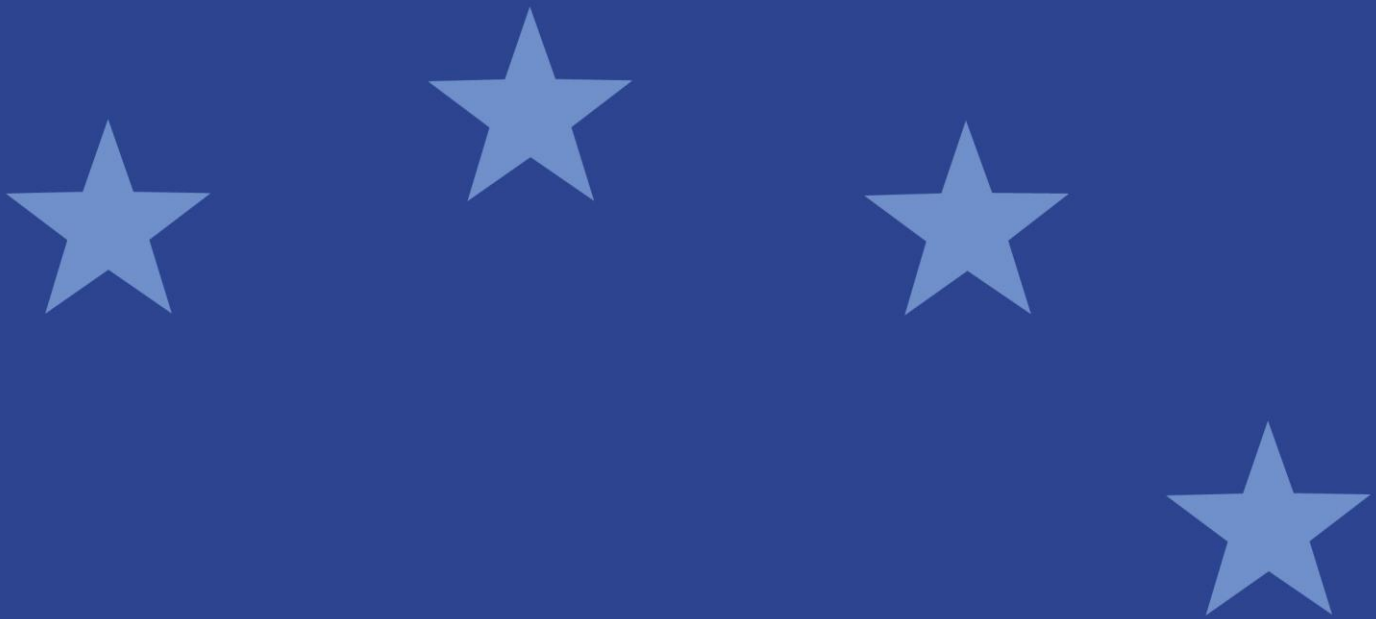




European Securities and  
Markets Authority

# Peer review into the NCAs' handling of relocation to the EU in the context of the UK's withdrawal from the EU

Peer review report





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## List of Terms and Acronyms

AML	Anti-Money Laundering
AuM	Assets under Management
BCP	Business Continuity Plan
BoS	Board of Supervisors
CBA	Cost Benefit Analysis
CoI	Conflict of interest
DRP	Disaster Recovery plan
ESMA Opinions	General Opinion, IF Opinion, IM Opinion and TV Opinion
EU	European Union
FTE	Full time equivalent. One FTE is equivalent to one employee working full-time
General Opinion	Opinion issued by ESMA on 31 May 2017 on the general principles to support supervisory convergence in the context of the United Kingdom withdrawing from the European Union (ESMA42-110-433)
IF Opinion	Opinion issued by ESMA on 13 July 2017 to support supervisory convergence in the area of investment firms in the context of the United Kingdom withdrawing from the European Union (ESMA35-43-762)
IM Opinion	Opinion issued by ESMA on 13 July 2017 to support supervisory convergence in the area of investment management in the context of the United Kingdom withdrawing from the European Union (ESMA34-45-344)
INED	Independent Non-Executive Director
Mandate	Mandate for this peer review as approved by the BoS in May 2021
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
Review Period	The period from 1 June 2017 to 31 December 2020
SCN	Supervisory Coordination Network
TV Opinion	Opinion issued by ESMA on 13 July 2017 to support supervisory convergence in the area of secondary markets in the context of the



United Kingdom withdrawing from the European Union (ESMA70-154-270)

# 1 Executive Summary

The UK's decision to withdraw from the EU (Brexit) triggered a series of actions at EU level to ensure that investor protection, orderly functioning of the markets and financial stability were safeguarded. One key concern for ESMA was to ensure a level playing field among jurisdictions in the context of relocation of entities and activities from the UK to the EU. This peer review was launched to assess how NCAs met the relevant requirements set in the regulation and clarified in the ESMA Opinions<sup>1</sup> when authorising relocating entities and activities from the UK to the EU.

This peer review needs to be seen as part of ESMA's other initiatives in the Brexit context, in particular the ESMA Opinions as well as the discussions in the Supervisory Coordination Network (SCN).

The creation of the SCN in May 2017 was a critical step to support National Competent Authorities (NCAs) applying a convergent approach in handling the relocation of entities because of Brexit. Composed of senior technical experts of the EU27 NCAs and chaired by ESMA's Executive Director, the SCN acted as a forum for NCAs to exchange views on key issues and good practices regarding market participants seeking to relocate entities or activities to the EU.

The SCN discussions allowed to identify some areas requiring specific attention from NCAs in the national authorisation process, as well as to discuss and compare respective supervisory approaches. The SCN discussions were held at high level and on a no-name basis, and as such they did not constitute a full review of all elements of the request for authorisation. Nevertheless, these discussions helped NCAs to form a view before taking any decision to grant authorisation. The SCN discussions led to common supervisory approaches in many cases and helped NCAs to evolve their handling of such authorisation requests. The SCN was an evolving process and each NCA adapted their authorisation review process over the course of the Brexit period in line with the discussions held and the feedback received at SCN level.

However, the final decision remained with the NCAs, and some differences in how NCAs approached these authorisations remained.

National supervisory practices continued to vary in specific areas, despite the recurring discussions taking place at SCN level. This is why, the SCN concluded that such areas could benefit from further convergence work. Therefore, the peer review focused on two of these key areas: the governance and the substance requirements set for relocating firms. The outcome of the peer review allowed for an in-depth understanding of the different supervisory approaches adopted in practice in these two areas.

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).

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<sup>1</sup> <https://www.esma.europa.eu/document/esma-issues-sector-specific-principles-relocations-uk-eu27> and <https://www.esma.europa.eu/document/general-principles-support-supervisory-convergence-in-context-uk-withdrawing-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)



## **Assessment areas**

This peer review differs from previous peer reviews conducted by ESMA in the sense that it covers the assessment of three distinct types of sectors (i) firms providing investment services and activities (MiFID firms) (ii) trading venues and (iii) fund managers.

The supervisory expectations set in the Mandate are the basis of the assessment made by the PRC across NCAs. The supervisory expectations defined for this peer review were set against the relevant legal requirements of these three sectors and ESMA Opinions regarding the authorisation of Brexit-related relocations of firms or activities. The key areas of focus were the same for all three sectors: entities' governance and substance requirements. However, for each sector, different regulatory requirements apply to these two areas of focus. In addition, each regulatory framework applies a different approach with regard to the content and the level of detail of the requirements on governance and substance. More specifically, the legislation relevant to the fund managers' sector (UCITS/AIFMD) is more prescriptive in terms of how certain requirements need to be met, whereas the legislation for MiFID firms and trading venues (both covered under MiFID II/MiFIR<sup>3</sup>) remains, for certain requirements, at a higher level. These differences allow for nuances on how NCAs can implement certain requirements (and still comply with the legal text). One clear example of these differences are the outsourcing/delegation requirements. This different philosophy is also reflected in the ESMA Opinions, with the fund managers' sector having the most prescriptive guidance. For these reasons, the outcome of this peer review may have come to different conclusions as to how a specific NCA met the supervisory expectations in one or another sector.

## **Jurisdictions assessed**

The peer review targeted different jurisdictions per sector based on data collected by the SCN. For MiFID firms, three jurisdictions i.e. CY, DE, IE, were selected based on (i) the number of authorised relocating firms providing investment services and activities to retail clients<sup>4</sup> and (ii) the complexity of these services/ activities. For trading venues, the three jurisdictions that authorised the highest numbers of trading venues were selected i.e. FR, IE, NL. Finally, for fund managers, four jurisdictions i.e. FR, IE, LU, NL were selected as they authorised the highest numbers of fund managers.

## **Overall findings**

The findings of this peer review were based on the NCAs' responses to the questionnaire, the on-site (virtual) visits and the engagement with stakeholders. In addition, the PRC asked to review a limited number of sample-cases<sup>5</sup> for each sector targeting both large and small firms. The sample documents did not allow on their own to draw general conclusions on the authorisation controls and checks conducted by NCAs, nor reflect how standards and processes have evolved over the course of the Brexit authorisation period. Nevertheless, they provided illustrative examples which helped the PRC to better understand national practices.

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<sup>3</sup> Regulation (EU) No 600/2014

<sup>4</sup> Excluding credit institutions

<sup>5</sup> The sample-cases are not intended to represent a significant proportion of the authorisation files granted in the jurisdiction but aim at illustrating the authorisation process of the NCA as described in the responses to the questionnaire and explained during the on-site visit.

All NCAs, to a certain extent, allowed for a phase-in approach, granting authorisations with certain conditions to be met after the authorisation but before the actual start of operations of the authorised entity. This approach was driven by the uncertainty on Brexit and the Covid 19 pandemic. The degree of flexibility, as well as the NCAs' approach in monitoring the compliance of entities with the conditions set before the start of the operations varied across NCAs. Given the NCAs' phase-in approach, the PRC assessed how NCAs met the supervisory expectations set under the Mandate at the authorisation stage taking also into account how they monitored that the relocated entities met the conditions, when starting to operate.

With regard to the outcome this peer review aims to achieve i.e. enhance supervisory convergence, the PRC had to consider one particularly challenging aspect. Brexit was by nature a one-off event. At the same time, any lessons learned from the peer review should be forward-looking. In addition, the PRC observed that NCAs did not apply a bespoke authorisation process to handle Brexit related applications. Therefore, the recommendations addressed to the NCAs do not intend to simply address an event that happened in the past, but to enable the NCAs, while implementing these recommendations, to strengthen further supervisory convergence in the authorisation process.

Regarding the supervisory approach, all NCAs, to different degrees, applied a risk-based approach. What the PRC also observed is that NCAs have different interpretation as to what constitutes a risk-based approach. In some instances, this risk-based approach led, in the PRC's view, to an outcome that was not in line with the requirements provided for under the ESMA Opinions. In addition, the PRC also observed, a case-by case application of the principle of proportionality, often with no concrete thresholds or set criteria. The use of the risk-based approach and the application of the proportionality principle have, in some instances, led NCAs to only impose very minimal requirements, in particular to smaller firms. As a result, the PRC believes it is disputable whether compliance with the legal requirements and related ESMA guidance was achieved in all cases. The definition and application of a risk-based approach and thresholds for proportionality are topics that have not been thoroughly discussed and agreed upon at an EU level across NCAs. There is merit to ensuring discussions take place to further align and harmonise approaches in this regard.

Finally, the PRC observed that NCAs allowed for an extensive use of outsourcing/delegation arrangements, and in some cases for limited technical and human resources to be relocated. These findings put into question (i) whether an adequate part of the activities have actually relocated into the EU and (ii) how autonomous and independent the relocated entities are.

### ***MiFID firms findings***

**Generally**, all NCAs granted authorisations with transitional arrangements. For one NCA (CY), conditions of authorisations were granted for specific and limited periods. Another NCA (DE) set no end date to the conditions of authorisations. Both these NCAs (CY, DE) relied on ongoing supervision to monitor the compliance with such conditions. One NCA (DE), in particular, relied on the annual audit by external auditors to monitor the conditions. However, in the absence of a formalised documented process for recording and communicating all conditions of authorisation, the conditions may not be adequately monitored to conclusion. One NCA (IE) also relied on conditions accompanying authorisations. However, this NCA (IE) monitored firms' compliance with the conditions attached to their authorisations through tools





available for their ongoing supervision and adapted the periodicity of firms' reporting obligations based on a risk-based approach.

Regarding **governance requirements**, overall NCAs appear to have appropriate processes and procedures to ensure that board members, senior managers as well as key function holders are suitable by checking all aspects of their suitability.

However, PRC observed that for small firms, two NCAs (CY, DE) did not ensure that senior managers dedicated sufficient time to their functions, as they both interpreted in a flexible manner the requirement<sup>6</sup> that a firm should be effectively directed by at least two persons, as required by the relevant legislation. In addition, for these two NCAs, the accumulation of roles sometimes created conflicts of interests which did not seem to be properly addressed or mitigated.

In addition, for one NCA (DE), a meaningful presence in the Member State of establishment was not always ensured for small firms. This mainly resulted from limited time commitment from senior managers as well as limited presence in Germany.

Regarding **substance requirements**, the PRC observed that, with regard to smaller firms, two NCAs (CY, DE) granted authorisations with very little substance in-house. In the case of one NCA (DE), the PRC identified that, for small firms, authorisation was granted with little substance set up in house but extensive intra-group outsourcing. This puts into question whether more functions were actually performed from the UK than the EU which, according to the ESMA Opinion in the area of investment firms<sup>7</sup> (IF Opinion) should not have been accepted. In addition, in the files reviewed by the PRC, for all NCAs, there were extensive outsourcing arrangements.

For two NCAs (CY, DE), the PRC did not find evidence that possible conflicts of interests were always addressed, especially in case of intra-group outsourcing arrangements which, together with the conflicts of interests not properly addressed in the governance structure, could risk compromising the independence of the firm.

For all NCAs (CY, DE, IE), the PRC found that internal control functions were allowed to be combined with other control functions as well as operational functions (and sometimes even executive functions), with NCAs not always able to fully demonstrate how such arrangements did not affect the effectiveness and independence of the relevant functions.

### ***Trading Venues findings***

Regarding the **authorisation procedures** applicable to relocating trading venues, all three NCAs (FR, IE, NL) applied the following principles: (i) no noticeable deviation from NCAs' standard authorisation procedure; (ii) setting up of a pre-application phase to anticipate the significant number of demands and share NCAs' supervisory expectations with possible applicants at a very early stage; and (iii) use of conditional authorisation and phased-in

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<sup>6</sup> Article 9(6) of MiFID II

<sup>7</sup> [https://www.esma.europa.eu/sites/default/files/library/esma35-43-762\\_opinion\\_to\\_support\\_supervisory\\_convergence\\_in\\_the\\_area\\_of\\_investment\\_firms\\_in\\_the\\_context\\_of\\_the\\_united\\_kingdom\\_withdrawing\\_from\\_the\\_european\\_union.pdf](https://www.esma.europa.eu/sites/default/files/library/esma35-43-762_opinion_to_support_supervisory_convergence_in_the_area_of_investment_firms_in_the_context_of_the_united_kingdom_withdrawing_from_the_european_union.pdf)

relocation of business and staff. However, the PRC also observed some differences, e.g. (i) two NCAs (FR, NL) had case-by-case approaches vis-à-vis potential applicants compared to the third NCA (IE) that adopted from the outset a clear and well-defined approach to all applicants without the possibility to derogate and (ii) one NCA (FR) adopted a strict follow-up to the conditions for authorisations agreed with relocating trading venues.

Regarding **governance requirements**, differences were identified regarding the controls and checks applied to organisational structures of relocating trading venues and, more specifically, the composition of their boards. The PRC welcomed in particular the approach adopted by one NCA (IE) which set very clear and concrete obligations to relocating trading venues without exception. The other two NCAs (FR, NL) opted for a case-by-case approach regarding the composition of boards, imposing limited across-the-board obligations. However, whereas one of them (FR) still endeavoured to maintain a certain degree of autonomy within the boards of relocated trading venues on a case-by-case basis, the other (NL) considered that full autonomy could not be achieved given the inherent inter-dependency of subsidiaries of international groups vis a vis their headquarters.

Although NCAs described rigorous controls during on-going supervision and, as explained below, solid checks regarding the overall resilience of relocated trading venues, the PRC considered that the specific risks relating to outsourcing (intra-group outsourcing in particular) had not been systematically taken into account at authorisation stage. The PRC observed that the NCAs imposed measures more on an ad hoc basis. For instance, the PRC regarded positively the fact that one NCA (FR) monitored the number of staff allocated within the service provider to outsourced activities.

In addition, the PRC observed that none of the NCAs under review requested a cost and benefit analysis or imposed formal due diligence processes with respect to notably intra-group outsourcing despite this being explicitly referred to in the ESMA Opinion in the area of secondary markets (TV Opinion) <sup>8</sup>.

All the three NCAs imposed monitoring arrangements for all outsourced services (included intra-group), however, the PRC notes that that the overall independence of this function could, in certain cases, also be indirectly affected by the shortcomings identified above in relation to the governance set-up and in particular the compositions of the boards of relocated trading venues.

Finally, the PRC considered that all NCAs put a very good amount of emphasis on the controls and checks performed with respect to systems' resilience and identified certain good practices in this respect. However, more safeguards could have been imposed on the compliance and risk functions.

Regarding the **substance requirements**, the PRC regretted that all NCAs authorised trading venues to relocate and operate with less staff working directly from the EU than outside the EU. Indeed, the PRC acknowledges that the overall uncertainties around Brexit could have resulted in supervisory challenges for the NCAs, However, the PRC considered that this was



a crucial element of the TV Opinion and that it should have been given more attention. The PRC therefore invites NCAs to set in place monitoring strategies regarding relocated trading venues with a view to establish a more balanced repartition between activities performed outside the EU and directly in the EU.

The TV Opinion allows for the possibility to outsource the technical arrangements related to key functions. The PRC observed an extensive use of this possibility, to such extent that in practice, in all three jurisdictions, relocated trading venues are relying heavily on the technical support from their group for the performance of key functions. The PRC would have expected NCAs to further challenge relocating trading venues in this respect.

In addition, the PRC considered that, in the case of two NCAs (FR, NL), the level of adherence with the TV Opinion can be disputed considering the overall independence and effective decision-making powers of relocated entities and their boards in particular.

Regarding the effective supervision of outsourced activities, the PRC welcomed the fact that (i) all outsourced activities were covered by entity specific Service Level Agreements (SLAs) allowing full access to the service providers for supervisory purposes and (ii) NCAs opened communication channels with UK authorities.

### ***Fund Managers findings***

In assessing the NCAs supervisory approach regarding the **governance** of applicant fund management firms, the PRC specifically focused on the supervisory expectations as set out in the Mandate and based on the ESMA Opinion in the area of investment management<sup>9</sup> (IM Opinion) related to decision-making, conflicts of interest and role of internal control functions.

The PRC noted that all NCAs had in place a supervisory assessment of governance structures that addressed the aforementioned topics to a certain extent. However, the PRC did find shortcomings mainly in the supervisory assessments and practices in relation to the governance structures of applicant firms.

This relates in particular to the lack of a thorough review of conflicts of interest management and related disclosures based on documentary evidence and the strong and independent role of internal control functions within the organisation.

Moreover, the PRC observed shortcomings regarding the assessment of the principle of proportionality. In this context, some NCAs used largely divergent quantitative thresholds which were up to 20 times higher in some Member States compared to others. This shows that further work is required with respect to the application of the proportionality principle to ensure supervisory convergence and a level-playing field for market participants across Member States.

In assessing the NCAs supervisory approach towards **substance**, the PRC specifically focussed on the supervisory expectations as set out in the Mandate related to the adequacy

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<sup>9</sup> [https://www.esma.europa.eu/sites/default/files/library/esma34-45-344\\_opinion\\_to\\_support\\_supervisory\\_convergence\\_in\\_the\\_area\\_of\\_investment\\_management\\_in\\_the\\_context\\_of\\_the\\_united\\_kingdom\\_withdrawing\\_from\\_the\\_european\\_union.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-45-344_opinion_to_support_supervisory_convergence_in_the_area_of_investment_management_in_the_context_of_the_united_kingdom_withdrawing_from_the_european_union.pdf)



of senior managers and human and technical resources as well as delegation arrangements and the monitoring of White Label service activity.

The PRC found that the supervisory practices of three NCAs (IE, LU, NL) did not meet supervisory expectations. As a result, the PRC found that NCAs had authorised applicant firms for which the overall number of senior managers and human and technical resources appeared insufficient. Only one NCA (FR) fully met the supervisory expectations in terms of the supervisory assessments concerning the adequacy of senior managers and human and technical resources.

The PRC also concluded that none of the NCAs (FR, IE, LU, NL) met supervisory expectations in relation to delegation arrangements. Indeed, the PRC observed that none of the NCAs performed a comprehensive review of delegation arrangements, in particular the objective reasons for delegation and compliance with due diligence requirements.

Regarding the monitoring of White Label service activity, the PRC specifically assessed how relevant NCAs addressed the supervisory expectations set out in the IM Opinion. This was only relevant to two NCAs (IE, LU). For the other two NCAs, one (NL) confirmed that they have no White Label service providers and the other (FR) that any White Label service providers located in that Member State were not Brexit related. While one NCA (IE) conducted supervisory work in line with the supervisory expectations, the other NCA (LU) did not specifically monitor this sector during the Review Period as stipulated in the IM Opinion and therefore was not in a position to provide precise information on the additional Brexit-related business gained by relevant entities in its Member State. Nevertheless, this NCA (LU) conducted a survey in the second quarter of 2021 (after the Review Period) on investment fund managers providing White Label services, focusing on the business increase and the investments in human and technical resources.

In light of the fact that two NCAs confirmed they have no relevant White Label service providers in their jurisdiction, no assessment of their monitoring activities could be performed for those NCAs and Table 1 below is therefore set to N/A in this respect.

**Table of findings**

The above findings are portrayed in a table format below showing to what degree supervisory expectations set in the Mandate are met in the view of the PRC. The respective assessments set in Table 1 vary across the three areas not only because of the differences in the supervisory expectations and in the ESMA Opinions but also because of the differences in the underlying regulatory requirements.

**TABLE 1 - ASSESSMENT OF NCAS**

**MIFID FIRMS**

		<b>CY</b>	<b>DE</b>	<b>IE</b>
<b>Governance</b>				
	Knowledge, expertise and commitment to the firm			
	Meaningful presence in the MS of establishment			

	Conflicts of interest			
	Board members & senior management			
<b>Substance</b>				
	Choice of MS of relocation			
	Human & technical resources			
	Outsourcing			
	Independence of internal controls			

## TRADING VENUES

		FR	IE	NL
<b>Governance</b>				
	Independence of board members & senior management			
	Impact of outsourcing on decision making powers and related risks			
	Cost and Benefit Analysis and due diligence applied to service providers			
	System resilience and internal controls			
<b>Substance</b>				
	Human & Financial resources			
	Outsourcing of key & important functions			
	Effective supervision of outsourcing arrangements with third-country service providers			

## FUND MANAGERS

		FR	IE	LU	NL
<b>Governance</b>					
	Independent and effective decision-making				
	Safeguards against conflicts of interest				
	Adequacy of the role of internal control functions				
<b>Substance</b>					
	Sufficiency of human and technical resources				
	Assessment of delegation arrangements				
	Monitoring of White Label service activity	N/A			N/A



#### COLOUR CODE LEGEND:

Fully meeting expectations	Largely meeting expectations	Partially meeting expectations	Not meeting expectations
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### *Recommendations*

The recommendations aim at strengthening the authorisation process of the NCAs, without being limited to the Brexit one-off event. In addition to the recommendations addressed to NCAs, some cross-cutting recommendations are identified for follow-up work at EU level.

Although recommendations relate to broadly the same topics, they are made for each of the three sectors covered by the peer review i.e. MiFID firms, trading venues and fund managers, taking into account the regulatory framework applicable to each sector.

The PRC would like to stress that this peer review aimed to identify some points for attention which might not only be relevant to the NCAs participating to the exercise but generally to all NCAs in the EU. In fact, the PRC considers that the evolving business models of entities across all industry sectors (e.g. increasing reliance on technology) and the consequences in terms of groups' organisation, governance, outsourcing and staffing practices – which were observed in the context of authorisations linked to Brexit relocations - could be considered a more general trend. Under this perspective, the PRC invites all NCAs to consider whether the findings and recommendations made in this report may also apply to their authorisation and supervisory practices.

### **MiFID firms**

On **governance**, and in relation to small firms only, CY and DE took a very flexible approach to the interpretation of Article 9(6) of MiFID II, accepting that firms be effectively managed by less than two FTEs. The PRC recommends that CY and DE set up requirements as to the minimum time that senior managers should be committing to the management of the firm. Also, the PRC recommends that DE sets concrete and effective materiality threshold on alternative arrangements when a firm will be managed by only one managing director.

In respect of conflicts of interests, the PRC recommends that CY and DE ensure, for all firms, that a conflict of interest policy is in place at authorisation stage and that all NCAs review such conflict of interest policy, as expected in the IF Opinion.<sup>10</sup> Lastly, the PRC recommends that CY and DE carefully consider situations of dual hatting and address any conflicts of interest that may result from them.

On **outsourcing**, the PRC recommends that DE assesses more thoroughly situations where extensive outsourcing arrangements may render an applicant firm a letter-box entity, and to ensure that outsourcing arrangements are in place at the moment of the authorisation or, at the very least, at the commencement of operations, as the peer review showed that this was not always the case.

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<sup>10</sup> ESMA35-43-762, paragraph 35.



The PRC also recommends that CY exerts accrued scrutiny on outsourcing arrangements to group entities, as such arrangements are susceptible of leading to enhanced conflicts of interest.

On the **independence of internal control functions**, the PRC recommends that all NCAs (CY, DE, IE) increase scrutiny before allowing the combination of control functions with other functions (such as executive, operational or other control functions).

Lastly, the PRC formulated two **recommendations related to both governance and substance requirements**. Firstly, the PRC recommends that DE establishes a formal process for recording all conditions of authorisation. Secondly, the PRC recommends that CY and DE implement a formal process to ensure follow up regarding the phasing out of transitional arrangements.

### **Trading venues**

Regarding the **governance**, the PRC recommends that FR and NL set clearer minimum requirements with respect to the overall governance structure of trading venues (e.g. regarding dual-hatting, time commitment, functional reporting). The PRC also recommends that FR and NL establish more concrete safeguards in order to strengthen the autonomy of the boards and to ensure that, beyond the formal decision-making powers, there are some concrete safeguards in place to limit the actual influence of the group on its EU subsidiary. These obligations should serve as a minimum set of rules that can be complemented on a case-by-case basis depending on the specific characteristics of the entity concerned (such as scale of activities, business model, etc).

The PRC also recommends that all NCAs (FR, IE, NL) set in place concrete controls and checks during on-going supervision to monitor the effectiveness of the decision-making powers that lie with relocated trading venues and their boards. This appears particularly relevant for key functions (i.e. trading systems, admission to trading, establishment and subsequent changes to the rulebook, suspension and removal of financial instruments from trading, trading halts, market surveillance) where a significant part of the activity and technical arrangements have been outsourced to entities of the same group.

For intra-group outsourcing, the PRC recommends that all NCAs apply the controls and checks that are typically required for outsourcing of activities to third-party providers such as assessment of risks, due diligence, cost and benefits analysis, as part of on-going supervision. Where appropriate, these controls and checks should be tailored to the nature and inherent features of intra-group outsourcing.

In addition, the PRC recommends that all NCAs adopt systematic and formalised IT checks and controls, given the increasing importance of IT issues for trading venues.

Regarding the **substance**, the PRC recommends that all NCAs better monitor, as part of their on-going supervision of relocated trading venues, the extent of outsourcing (e.g. in terms of number of staff and percentage of revenue that is paid back for the performance of outsourced activities) with a view to establish a more balanced set up and repartition between activities performed outside and within the EU. Outsourcing should not be considered as an inevitable



outcome for trading venues that belong to large international groups and NCAs should dedicate more efforts on convincing relocating entities to have more activities (including technical arrangements) being relocated, allowing only in duly justified cases the outsourcing of technical support to the performance of key activities. This monitoring and the consequent rebalancing of resources should be considered for both the overall organisational set up of relocated trading venues and in particular for key and important functions.

## **Fund Managers**

With respect to **governance**, the PRC recommends that all NCAs (FR, IE, LU, NL) introduce a more systematic and thorough approach to reviewing potential and actual conflicts of interest during the authorisation stage and scrutinising more closely the combination of responsibilities, roles, functions or reporting lines which may result in a conflict of interest or impair the principle of independence of control functions.

The PRC recommends that FR and IE introduce a more systematic and thorough approach to reviewing the key policies and procedures of applicant firms. In addition, the PRC recommends that IE and LU review the current quantitative thresholds applied to determine proportionality.

The PRC recommends that all NCAs (FR, IE, LU, NL) scale up the efforts to review the establishment and strong role of internal control functions, verifying in particular the appropriate interaction between portfolio and risk management and sound escalation procedures.

With respect to **substance**, the PRC recommends that IE, LU, NL introduce a more thorough review of the adequacy of human and technical resources, and that all NCAs (FR, IE, LU, NL) introduce a more systematic and thorough supervisory approach in reviewing delegation arrangements.

With respect to White Label service providers, the PRC recommends that LU monitor its White Label industry more closely given the specific supervisory risks posed.

## **Cross-cutting recommendations**

The PRC identified cross-cutting issues that due to their nature would merit follow-up work at EU level to foster supervisory convergence. These are the application of (i) the risk-based approach, (ii) the proportionality principle and (iii) outsourcing / delegation arrangements, which varied significantly across NCAs.

### ***Good practices***

Some good practices were also identified across the three areas covered in the peer review. They are presented per area in order to be specific so to ease implementation by other NCAs.

## **MiFID firms**

On **governance**, the PRC identified the following good practices in the supervisory approach of the NCAs assessed:



- Conducting interviews in addition to the written vetting process depending on the risk classification of the applicant firm, the nature of its business and/or any potential issue being identified (CY, IE);
- Conducting a pre-approval on-site visit for each applicant firm prior to granting authorisation, (CY); and
- Obligation for firms to liaise with the NCA if their activities increase by more than a certain percentage compared to the projections submitted in their business plan (CY, IE).

On **substance**, the PRC identified the following good practice:

- Conducting on-site inspections addressing the topic of the resources dedicated to the planned activities at the authorisation stage (CY).

### Trading venues

On **governance**, the PRC identified, amongst others, the following good practices in the supervisory approach of the NCAs assessed:

- Setting clear obligations on Board members (e.g. INED Chair for the board of relocated trading venues), with no possibility for derogation and no possible dual hatting for certain functions (IE);
- Imposing concrete measures to mitigate operational risk relating to outsourcing (e.g. non-intermediated kill switches, local disaster recovery site) (IE);
- Reviewing the staff dedicated, within the group, to the performance of outsourced activities (FR);
- Requiring the appointment of a specific person in charge of the outsourcing oversight (FR, IE, NL);
- Using detailed checklists (so-called work programme), listing all relevant requirements (EU and domestic requirements) (NL);
- Imposing the submission of a first RTS 7 self-assessment during the authorisation phase and responding to a questionnaire on IT risks to all applicants (IE);
- Applying a six-eyes review approach for issues relating to systems' resilience involving the IT team, the authorisation assessment officers and the relevant supervisors (NL).

On **substance** the PRC identified the following good practices in the supervisory approach of the NCAs assessed with regard to the key and important functions:

- Requiring voice brokers to be located in France - in particular those executing transactions on behalf of on EU clients (FR);
- Imposing tailored policies, procedures and rulebooks (FR, IE).

### Fund managers



The PRC identified the following good practices in the supervisory approach of the NCAs assessed:

- Using detailed checklists covering the key legal requirements and paragraphs set out in the ESMA Opinions with a view to ensuring comprehensive and consistent supervisory assessments (NL);
- Conducting a detailed review of the envisaged portfolio management process, including the review of detailed order flows (pre-placement, validation and registration of orders and reconciliation of positions etc.) (FR);
- Conducting a comprehensive assessment of the technical resources of applicant firms to obtain a good overview of the various IT tools and systems used by applicant firms and their delegates (FR);
- Requiring applicant firms to appoint an independent non-executive director as Chair of the board of directors providing for additional escalation possibilities and more independent decision-making processes (IE);
- Conducting a thorough review of the Risk Management Process and related documentation particularly through comprehensive and, where possible, standardised assessments (LU).

## 2 Introduction

1. This report presents the main findings of the peer review carried out into some NCAs' handling of relocation of UK entities to the EU in the context of the UK's withdrawal from the EU.
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 the NCAs' handling of relocation to the EU in the context of the UK's withdrawal from the EU; (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 [to add or delete as applicable in the final report - statements provided by [NCAs].

### 2.1 Background

3. As the UK played a prominent role in the EU Single Market, the relocation of entities and activities into the EU following the UK's decision to withdraw from the EU required a common effort to ensure a consistent supervisory approach at EU level to safeguard investor protection, the orderly functioning of financial markets and financial stability.
4. This peer review is an integral part of ESMA's Brexit related work and one of the key actions taken to ensure a level playing field among jurisdictions in the context of the UK's decision to withdraw from the EU. In that context, the BoS decided through the Supervisory Convergence Work Programme for 2019 to conduct a peer review on the NCAs' handling of relocation to the EU in the context of the UK's withdrawal from the EU. Furthermore, this peer review acts as follow up to ESMA's other initiatives in the Brexit context, in particular the ESMA Opinions as well as the discussions in the SCN that was established to enhance mutual understanding of key issues arising from relocation.
5. The creation of the SCN in May 2017 was a critical step to support NCAs applying a convergent approach in handling the relocation of entities because of Brexit. Composed of senior technical experts of the EU27 NCAs and chaired by ESMA's Executive Director, the SCN acted as a forum for NCAs to exchange views on key issues and good practices regarding market participants seeking to relocate entities or activities to the EU until six months after the UK left the EU.
6. The SCN discussions allowed to identify some areas requiring specific attention from NCAs in the authorisation process, as well as to discuss and compare respective supervisory approaches. The SCN discussions were held at high level and on a no-name basis, and as such they did not constitute a full review of all elements of the request for authorisation. Nevertheless, these discussions helped NCAs to form a view before taking any decision to grant authorisation. The SCN discussions led to common supervisory approaches in many cases and helped NCAs to evolve their handling of such authorisation requests. The SCN was an evolving process and each NCA adapted their authorisation review process over the course of Brexit period in line with the discussions held and the feedback received at SCN level. However, the final decision remained with the NCAs, and some differences in how NCAs approached these authorisations remained.

7. National supervisory practices continued to vary in specific areas, despite the recurring discussions taking place at SCN level. For instance, SCN members stressed in certain cases that they were not comfortable with the authorisation of a firm with the limited staffing proposed, or with the support by the group and whether it qualified as delegation. This is why, the SCN concluded that such areas could benefit from further convergence work. Therefore, the peer review focused on two of these key areas: the governance and the substance requirements set for relocating firms. The outcome of the peer review allowed for an in-depth understanding of the different supervisory approaches adopted in practice in these two areas.
8. This peer review assesses the extent to which NCAs meet supervisory expectations set on the basis of relevant legal requirements and the ESMA Opinions, including the supervision of the implementation of the authorisation and follow-up supervisory checks in this respect. It was conducted in accordance with Article 30 of ESMA Regulation<sup>11</sup> and the Peer Review Methodology<sup>12</sup>.

## 2.2 Scope of the peer review

9. The peer review focuses on the authorisation and related supervisory aspects of three distinct types of sectors, namely (i) firms providing investment services and activities (hereafter “MiFID firms”)<sup>13</sup>, (ii) trading venues<sup>14</sup> and (iii) fund managers<sup>15</sup>.
10. The supervisory expectations set in the Mandate are the basis of the assessment made by the PRC across NCAs. The supervisory expectations defined for assessing this peer review were set against the relevant legal requirements of these three sectors and ESMA Opinions regarding the authorisation of Brexit-related relocations of firms or activities. The peer review is focused on two key areas: (i) entities’ governance and (ii) the substance requirements set for entities. It considers, in particular, NCA’s supervisory practices in relation to key regulatory requirements related to the conditions and procedures for authorisation as well as for the firm to start operating its activities in the following areas:
  - a. For MiFID firms, (i) the management’s knowledge, expertise and commitment to the firm, (ii) whether the governance structure is appropriate (prevention and/or management of conflicts of interests, resources, (iii) whether the choice of the Member State of establishment is driven by objective factors and the firm has a meaningful presence there, (iv) the resources available to the firm and their source (outsourcing) and (v) whether the internal control functions are independent.
  - b. For trading venues, (i) organisational structures, governance arrangements and decisions-making processes, (ii) system resilience, risk monitoring and controls as well as rules, procedures and systems to ensure fair and orderly trading, (iii) access to, functioning of the system and trading process as well as rules and procedures for the admission, suspension and removal of financial instruments to/from trading.

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<sup>11</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010.

<sup>12</sup> [esma42-111-4966\\_peer\\_review\\_methodology.pdf \(europa.eu\)](https://esma.europa.eu/media/42/111-4966_peer_review_methodology.pdf)

<sup>13</sup> MiFID firms encompass investment firms as defined in Article 4(1)(1) of MiFID II (excluding credit institutions providing investment services and activities within the meaning of Article 4(1)(2) of MiFID II).

<sup>14</sup> Trading venues encompass market operators and investment firms operating a regulated market, a MTF or an OTF.

<sup>15</sup> Fund managers encompass internally and externally managed AIFMs (including registered and authorised AIFMs of EuVECA) as well as UCITS management companies and self-managed UCITS investment companies.

- c. For fund managers, covering both external AIFMs and internally managed AIFs<sup>16</sup> as well as UCITS management companies and self-managed UCITS investment companies, (i) independent and effective decision-making, (ii) safeguards against conflicts of interest, (iii) adequacy of the role of internal control functions, (iv) sufficiency of staffing and technical resources, (v) assessment of delegation arrangements and (vi) monitoring of White Label service activity.
11. The independence of the NCAs is covered in the Report on the Independence of NCAs published by ESMA on 18 October 2021<sup>17</sup>.

## 2.3 NCAs under review

12. The peer review covered six jurisdictions among those NCAs that received authorisation requests from relocating entities. The focus on NCAs varied depending on the respective sectors:
  - a. For MiFID firms, given the large number of such firms relocating in the EU from the UK and the variety of their business/operating models, a risk-based approach was adopted, with a particular focus on investor protection. As a result, the focus of the peer review is on MiFID firms providing investment services and activities to retail clients, excluding credit institutions.<sup>18</sup> With this background, taking into account the number of such relocating firms, the complexity of the services / activities performed and considering the information collected by the SCN on MIFID relocating firms, the peer review assesses CY, DE and IE.
  - b. For trading venues, taking into account the information collected by the SCN on trading venues relocating into the EU from the UK, the peer review assesses the three NCAs that authorised the highest numbers of trading venues, namely FR, IE and NL.
  - c. For fund managers, taking into account the information collected by the SCN on fund managers relocating into the EU from the UK, the peer review assesses NCAs that authorised the highest numbers of fund managers: FR, IE, LU and NL.

These NCAs are listed in Table 2 below.

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<sup>16</sup> Article 5(1) of AIFMD sets out that the AIFM shall be either: (a) an external manager, which is the legal person appointed by the AIF or on behalf of the AIF and which through this appointment is responsible for managing the AIF (external AIFM); or (b) where the legal form of the AIF permits an internal management and where the AIF's governing body chooses not to appoint an external AIFM, the AIF itself, which shall then be authorised as AIFM (internally managed AIF).

<sup>17</sup> [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)

<sup>18</sup> The focus of the peer review on MiFID firms providing investment services and activities to retail clients was not always totally followed by BaFin when providing sample files. Most of the applicants for authorisations in Germany, especially on the small side, focus on institutional clients and when compiling the data, the file samples and the stakeholders, such firms have been included by BaFin.

**TABLE 2 - NCAs ASSESSED IN THE PEER REVIEW**

Code	Country	Competent Authority	Acronym	Assessment
NL	The Netherlands	Autoriteit Financiële Markten	AFM	TV, FM
FR	France	Autorité des Marchés Financiers - Autorité de Contrôle Prudentiel et de Résolution	AMF, ACPR	TV, FM
DE	Germany	Bundesanstalt für Finanzdienstleistungsaufsicht	BaFin	MiFID firms
IE	Ireland	Central Bank of Ireland	CBol	MiFID firms, TV, FM
LU	Luxembourg	Commission de Surveillance du Secteur Financier	CSSF	FM
CY	Cyprus	Επιτροπή Κεφαλαιαγοράς Κύπρου	CySEC	MiFID firms

## 2.4 Process of the peer review

13. The peer review was carried out by the ad hoc PRC composed of experts from NCAs and from ESMA staff and chaired by a senior ESMA staff member.
14. As a basis of the assessment, in May 2021, the PRC addressed a questionnaire (enclosed in Annex 2) to the NCAs in scope, followed by complementary information and documentation requests. On-site visits<sup>19</sup> took place remotely to the six NCAs in scope between October and December 2021. Such on-site visits to NCAs, including the related access to 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. Indeed, although the sample documents did not allow on their own to draw general conclusions on the authorisation controls and checks conducted by NCAs, nor reflect how standards and processes have evolved over the course of the Brexit authorisation period, they provided illustrative examples which helped the PRC to better understand national practices. The PRC wishes to note that visited NCAs engaged openly and constructively and to thank the NCAs for the good cooperation in this peer review.
15. During these virtual visits, and in order to better understand the authorisation process of firms in the EU, the PRC engaged also with stakeholders in each country visited, as facilitated by the respective NCA. In total, the PRC engaged with 13 stakeholders that are broken down to five MiFID firms, three trading venues and five fund managers. The outcome of discussions with stakeholders was taken into account in the assessment.
16. The period under review covers 1 June 2017 to 31 December 2020 (Review Period).
17. [The PRC reported its findings to the BoS, for its approval, after having consulted the Investors Protection Standing Committee (IPISC), the Secondary Market Standing Committee (SMSC) and the Investment Management Standing Committee (IMSC), as

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

the relevant Standing Committees for the topics at stake, and the Management Board (MB).]

18. For each assessment area, the Mandate identifies supervisory expectations against which NCAs have been assessed. Considering these expectations, the PRC made a qualitative assessment whether for each of the 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 assessment areas are included in Sections 4.1 to 4.3. The assessment table for all NCAs and the areas for improvement identified are set out in Section 4.4. Good practices identified in each assessment area are presented in Section 4.5.

### 3 General information

19. This section sets out background information on the organisational arrangements put in place by NCAs to handle Brexit-related authorisation applications.

#### Overview of authorisation applications and notifications of material changes

##### TABLE 3 BELOW PROVIDES

20. Table 3an overview on (i) the total number of successful applications out of the total number of applications received, with a breakdown per area covered by the peer review, and (ii) the total number of notifications of material changes approved by NCAs out of the total number of notifications of material changes received. DE did not record statistics of the notifications of material changes it received and as such was not able to indicate how many notifications of material changes were submitted to it as a result of Brexit.

TABLE 3 – NUMBER OF APPLICATIONS AND NOTIFICATIONS OF MATERIAL CHANGES<sup>20</sup>

	NL	FR	DE	IE	LU	CY
<b>Trading venues</b>						
<b>Total number of applications that led to authorisation / Total number of applications received</b>	10/10	8/9		5/5		
<b>Total number of notifications of material changes that were approved / Total number of notifications of material changes received</b>	0/0	1/2		0/0		
<b>Fund managers</b>						
<b>Total number of applications that led to authorisation / Total number of applications received</b>	3/5	14/15		48/50	18/19	
<b>Total number of notifications of material changes that were approved / Total number of notifications of material changes received</b>	0/0	43/43		12/14	22/22	

<sup>20</sup>[Numbers differ from those in the SCN closing report as the peer review covers a longer period (until December 2020 vs February 2020 for the SCN) and the SCN did not distinguish between material changes and authorisation.

<i>MiFID firms</i>						
<i>Total number of applications that led to authorisation / Total number of applications received</i>			37/43	26/42		6/13
<i>Total number of notifications of material changes that were approved / Total number of notifications of material changes received</i>			No recording	0/2		1/5

### Implementation of Brexit specific policies, procedures and supervisory approach

21. All NCAs used their current authorisation process but adjusted it to take into account the expectations in the ESMA Opinions. Furthermore, NCAs took additional actions as a result of Brexit. One NCA (NL) set up a cross-organisational programme, a specific internal governance including a project team and a steering committee and expanded its communication in English on its website. Another NCA (DE) also established an internal steering committee on issues arising in the context of Brexit as well as a sub-group dedicated to streamline authorisation procedures of medium to large sized investment firms and a team dedicated to coordinate these authorisation procedures. Two NCAs (DE, FR) introduced English in their documentation and communications towards market participants. Other examples of changes included the set-up of a Brexit FAQ (DE), of a Brexit information hub (CY), a review of policies, procedures, guidance and forms to reflect Brexit (IE) or internal guidance (CY).
22. Considering the above adjustments, the PRC has not observed specific issues related to NCAs independence in the authorisation process and supervisory approach in the scope of the relocation of firms following the UK withdrawal from the EU. Please also refer to the Report on the independence of National Competent Authorities published by ESMA in October 2021<sup>21</sup>.

### Review and on-site verification following authorisation

23. All NCAs indicated that firms were subject to regular ongoing supervision following authorisation, using their risk-based approach<sup>22</sup>. It is worth noting that for MiFID firms, one NCA (CY) carried out on-site inspections at the firms' premises to assess their compliance with the authorisation conditions and substance requirements prior to authorisation.
24. In case of specific conditions to be met within a certain time frame after approval, two NCAs (LU, NL) performed checks although not necessarily through on-site verification. Another NCA (FR) conducted a specific follow-up across different types of entities to monitor adherence of the authorised firms with the commitments they initially took, in particular in terms of resources. Another NCA (IE) conducted systematic checks for high impact firm and used other reporting tools to monitor the compliance with conditions set at authorisation stage as part of their ongoing supervision activities.
25. Regarding fund managers, one NCA (LU) noted that three firms authorised in the context of Brexit were subject to on-site visit in 2019 and 2020 where the operating conditions

<sup>21</sup> [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)

<sup>22</sup> E.g. PRISM for IE, RBS-F for CySEC, G2.1 plus set of annual reports for CSSF. For BaFin, depending on the size of the firm, the business model and the risk of consumer detriment, interviews take place on a yearly basis or every three years



and in particular the organisational requirements, the oversight of delegated activities, the internal control functions, the conflicts of interest and the conduct of business were analysed.

26. Regarding trading venues, an NCA (NL) noted that regular on-site meetings with all authorised trading venues took place and that specific investigations were conducted for many of them. Another one (FR) stressed that they performed intense follow-up supervisory work to ensure conditions set or commitments taken by the applicants were actually implemented, noting that the licence was only activated after completion of the conditions. However, another NCA (IE) noted that, as some firms were not operational before 2021, in practice no engagement took place with them before that date.

### **Resources dedicated to authorisation**

27. All NCAs increased their resources to cope with the increase in application authorisations due to Brexit but they did so to a different extent. Additional resources allocated to Brexit-related authorisations came either from budget increases or from a de-prioritisation of other work streams.
28. The number of applications per full-time equivalent (FTE) varied at NCAs over the period under review. For MiFID firms, the highest number of applications per FTE ranged from 1.6 (IE) to a ratio of 11 applications per FTE at DE<sup>23</sup>. For trading venues, it ranged from 1.3 (IE) to the highest ratio of 2.3 applications per FTE at NL. Finally, for fund managers, it ranged from 2.3 (FR) to 26.9 (LU) applications per FTE, although the latter also includes notification of material changes, which is a different approach from other NCAs<sup>24</sup>. The highest numbers were observed between 2017 and 2019.
29. It is important to note that for some NCAs the number of applications indicated above includes only authorisation for a licence whereas for some other NCAs, it includes both authorisation for a licence and authorisation following a notification of material changes. While these numbers provide a relevant indication on the resources dedicated to the authorisation, the PRC notes that the comparability of NCAs' resources should be considered very carefully due to NCAs' organisational arrangements and the fact that the complexity and therefore the resources required to handle an application for authorisation may vary from one application file to another. Likewise, assessing applications for initial authorisation are often more resource-intensive in nature than applications for material changes of existing authorisation.

### **Compliance with requirements at authorisation time**

30. Given the overall uncertainties around Brexit, NCAs allowed for some conditions to be fulfilled at a later stage.
31. An NCA (FR) granted authorisation under conditions but only activated the authorisation when the conditions were met. In some cases, that NCA agreed that a firm finalises a specific procedure between the date of authorisation and the actual start of activity.

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<sup>23</sup> As part of the two-peak system established in Germany, Deutsche Bundesbank also participates in the authorisation process and provides memoranda on the files. The Deutsche Bundesbank personnel involved has not been included in this calculus.

<sup>24</sup> The PRC could not compute a ratio of the number of fund manager applications per FTE for AFM given that the staff handling fund manager applications were also dealing with MiFID firm applications, sector for which the AFM was not assessed as part of the peer review.

32. Other NCAs (DE, IE, LU, NL) also granted authorisations with conditions (mainly related to staffing requirements, phase-in period and changes) but immediately activated the authorisation. One NCA (LU) stressed that this was allowed in scarce cases and was followed up as part of the on-going supervision. Two other NCAs (CY, IE) set conditions in the letter of authorisation with a timeframe not exceeding six months for completion. Another NCA (DE) relied either on the oversight of the external auditors and their annual reports, or on the notification by the applicants regarding the commencement of business and the fulfilment of the conditions set in the authorisation. However, this NCA did not set a timeframe for the applicants to notify that they had met the conditions or ended any transitional arrangements, nor defined to the external auditors any specific criteria with regard to transitional arrangements and conditions for the audit reports.

### **Cooperation with third country supervisors**

33. NCAs (CY, DE, FR, IE, LU, NL) have agreed a Memorandum of Understanding (MoU) with the UK authorities (UK FCA and Bank of England as needed) based on the ESMA template to be able to share information and expertise. They liaised with the UK authorities for applications but did not rely on any decisions taken by the UK authorities. It allowed them to get information on any form of legal proceedings against the applicant in the UK.
34. Some NCAs (FR, NL) indicated that during their assessment, they checked that the outsourcing agreement ensures access of the competent authority to the third country service provider. Other NCAs (DE, IE) asked the firm to ensure such access. One NCA (CY) ensured to have a cooperation agreement in place with the third country authority of the service providers.

## **4 Peer review findings**

35. The following sections contain a summary of the peer review findings as follows: (i) the assessment of the two assessment areas (governance and substance) per sector and a summary of the on-site visits (Section 4.1); (ii) the assessment table and the PRC recommendations (Section 4.4); (iii) the good practices that the PRC identified (Section 4.5).

### **4.1 Peer review findings: MiFID firms**

36. The PRC assessed whether NCAs ensure that: (i) board members, senior managers and key function holders have the necessary knowledge and expertise as well as dedicate sufficient time to effectively manage the applicant firm; (ii) senior managers and key function holders have a meaningful presence in the relevant country; (iii) the allocation of functions (in particular relating to risk taking and independent control) within the applicant firm avoids conflicts of interest; and (iv) sufficient human and technical resources are available to each senior manager and key function holder to enable them to effectively discharge their role.
37. The supervisory expectations listed above are further described in the introduction of each assessment area below.



#### 4.1.1 Governance

##### 4.1.1.1 Knowledge, expertise and commitment to the firm

38. In accordance with paragraph 15 of the IF Opinion, board members, senior managers and key function holders should have the necessary knowledge and expertise for and should dedicate sufficient time to effectively manage the firm. The NCA should therefore carefully assess board members, senior managers and key function holders' long-term commitment to the firm and its relocation as well as links (including non-financial relationships) with any group entities and how that may increase conflicts of interests or impact their time commitment towards the firm.
39. Whilst the need to ensure that firms are managed by fit and proper individuals is of paramount importance in all cases (not just for entities relocating activities from the UK to the EU), time commitment is particularly relevant in the Brexit context. UK entities may have been tempted to use staff they already had to manage and work for the new EU entity only on a part-time basis while also keeping their functions in the UK entity or group. This approach may impact the functioning and independence of the EU firm as well as may give rise to conflicts of interests.

#### Summary of findings

40. All NCAs (CY, DE, IE) ensure that the persons effectively directing the business, board members and key function holders have the necessary knowledge, skills and experience and are of sufficiently good repute to effectively manage the investment firm. One NCA (IE) relies on an online questionnaire.
41. In addition to the vetting process performed in written form by all NCAs, two NCAs (CY, IE) also interview applicants. One NCA (IE) indicated that the team in charge of the fitness and probity assessment perform interviews for all applicants of medium-high risk firms and above. In addition, applicants of any firm will be interviewed where a competency, fitness to act or probity issue is flagged. The other NCA (CY) indicated that the need for interviews of board members, senior managers and/or key function holders was assessed on a case-by-case basis where a competency, fitness to act or probity issue was flagged. In addition, CY conducted a pre-authorisation onsite inspection of all applicant firms during which meetings and interviews were conducted with senior management, the compliance officer as well as, for CFD firms, the head of sales and marketing.
42. Two NCAs (CY, DE) also indicated using other sources of information by (i) sending fit and proper requests to other relevant NCAs where an applicant has been previously assessed by such NCA(s) and (ii) performing Google searches (CY, DE), Worldchecks and Comply Advantage checks (CY). Regarding minimum criteria applied to applicants, one NCA (IE) indicated that it relies on the EBA Guidelines on internal governance under Directive 2013/36/EU and two NCAs (CY, IE) indicated that they relied on the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU. One NCA (DE) indicated that it considers that a person that demonstrates three years' managerial experience at an institution of comparable size and type of business as that of the applicant firm, is considered to have the necessary professional qualifications.

43. Regarding time commitment to the applicant firm by persons effectively managing the business and key function holders, all NCAs (CY, DE, IE) check the time that such persons will dedicate to their functions to effectively manage the firm.
44. Two NCAs (CY, IE) indicated applying minimum criteria regarding time commitments or otherwise limiting on the number of management or supervisory mandates one person can hold.
45. One NCA (CY) adopted a policy under which one applicant may hold a maximum of (i) one executive position in a non-significant firm and at the same time up to four non-executive positions in other firms or (ii) eight non-executive positions in non-significant firms.
46. IE indicated that, for executive roles, it requires the following minimum: (i) a full time equivalent (FTE) role (ii) with a minimum expectation of a time commitment of 216 to 240 days.
47. However, both NCAs (CY, IE) indicated that the above limits and/or minimum criteria are indicative and that they assess each case in light of the proportionality principle and may thus require from applicants that they further limit the number of mandates they hold and/or dedicate more time to their role in the applicant firm. From the files reviewed, the PRC noted that CY granted authorisations to firms with managing directors holding two or more executive directorships within the same group.
48. The PRC found that all NCAs enquire about the time that senior managers and key function holders will commit to their role in the applicant firm. However, the PRC also found that expectations in this respect varied from one NCA to the other.
49. DE indicated that it applies the proportionality principle on a case-by-case basis. Although there are no set-in-stone minimum requirements regarding time commitments or maximum number of mandates one person can hold, the German Banking Act (KWG) explicitly requires that senior managers have to dedicate sufficient time to perform their functions. DE further specified that, to ensure consistency (as different application files were handled by different staff members), every application file was submitted to the Evidence Unit where they compare cases. In addition, the final written assessment was checked by the head of division.
50. Regarding time commitment, it was evident from the sample files presented that DE enquired about the time that senior managers and key function holders would be able to dedicate to their functions in the applicant firm. DE then applied the proportionality principle to assess whether the time committed by senior managers and key function holders of the applicant firm to their functions was sufficient, taking into account the size of the firm and the type of activities. The sample files further showed that DE did not necessarily require senior managers to work full-time for the firm. In one application file, DE accepted one full-time managing director and two part-time managing directors dedicating, in total (for both of them), 100 days per year to the management of the firm – therefore representing in total less than two FTEs to manage the firm. In that same file, the two managing directors working part-time for the German applicant firm were to retain their functions in the UK investment firm, at least initially, while also working for the German entity. In another file, DE accepted, although for an interim period of one year,

that the firm would be managed by one part-time managing director (dedicating at least 50% of his/her time to the management of the firm).<sup>25</sup> Both cases related to small firms.

51. DE further reported that, due to the uncertainty on Brexit, applicant firms – especially the smaller ones, were hesitant to build up capacity that might not be needed at a later stage. In such cases, DE accepted that applicants built up their resources in Germany over time and depending on business development after the granting of the authorisation. In such cases, no formal conditions were included in the authorisation letter, but DE relied on ongoing supervision, including external auditors, instead. No specific comments were however included for the attention of external auditors who, nonetheless, had access to the authorisation file.
52. DE indicated that it assessed time commitment to the applicant firm versus professional as well as social obligations.
53. One NCA (IE) indicated that for all firms, they required a minimum of two executive directors (or persons effectively managing the business) working for the applicant firm on a full-time basis and resident in Ireland. IE provided the PRC with evidence to that effect.
54. Another NCA (CY) also indicated requiring a minimum of two executive directors (or persons effectively managing the business) working for the applicant firm on a full-time basis. For CFD firms as well as significant firms<sup>26</sup>, CY also requires that at least two executive directors reside locally and do not hold other executive positions, even within the same group. For small firms or firms with non-complex business models, CY accepted that senior management and key function holders did not work full-time for the applicant firm (because of senior management responsibilities in other entities) and/or cumulated their executive directorships with other operational functions. For one firm whose authorisation case was reviewed by the PRC, it was unclear whether the total time committed by all executive directors to the management of the firm (on a cumulative basis) even amounted to two full-time persons managing the business. The NCA (CY) cited the following alternative arrangements as considered appropriate under Article 9(6) of MiFID II: i) relocation of one of the managing director to Cyprus and ii) appointment of a third managing director, on a part-time basis. However, on the basis of the evidence provided, the PRC deemed that such alternative arrangements did not appear to guarantee that the level of two full-time persons managing the business was reached.<sup>27</sup>

## Analysis

55. The PRC considers that, overall, NCAs processed the applications of the persons effectively directing the business, board members and key function holders effectively so as to ensure that such persons had the necessary knowledge, skills and experience and were of sufficiently good repute to effectively manage the investment firm.

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<sup>25</sup> This interim period was due to BaFin initially judging the proposed managing director as not having sufficient experience in relation to the activity of discretionary portfolio management. They thus required such applicant to gain more experience in this field for a period of one year before it could take up his/her functions as managing director of the German firm. In the meantime, an interim managing director was appointed and such person committed to dedicate 50% of his/her time to the firm.

<sup>26</sup> Firms are deemed significant depending on the nature of their activities, their scale and their complexity. The assessment made by CySEC for this purpose differs from the criteria applied to determine whether a firm is "significant" under Directive 2013/36/EU.

<sup>27</sup> As the relocation of one of the managing director to Cyprus would not necessarily have an impact on his time commitment to the firm (as this managing director still held other mandates in other entities) and the appointment of the third managing director was only on a part-time basis.

56. The PRC positively notes that, in addition to the written vetting process, two NCAs (CY, IE) also conducted interviews to varying degrees depending on the risk classification of the applicant firm, the nature of its business and/or any potential issue being identified.
57. For CY, the PRC further positively notes that it conducted, for each applicant firm prior to granting authorisation, a pre-approval on-site visit during which it interviewed, as a minimum, the persons effectively directing the firm as well as the compliance officer (and head of sales for CFD firms).
58. Regarding minimum criteria applied to applicants regarding their knowledge, skills and experience, the PRC was satisfied that all NCAs thoroughly ensured that the applicants were suitable.
59. Regarding time commitment dedicated to the applicant firm by applicants, the PRC was satisfied that all NCAs enquired about other commitments of the applicants and the time that such persons would dedicate to their functions to effectively manage the firm.
60. The PRC was, however, concerned by the thresholds applied by two NCAs (CY, DE) regarding time commitments for small firms with non-complex activities. For DE, although checks were performed, for small firms, the sample files provided showed that, in one instance, DE allowed applicants (managing directors) to retain their full-time functions in the UK entity on the basis that the firm was small and the business was just starting and, in another instance, agreed, for an interim period (one year), that the firm would be run by one managing director working only part-time. Although the PRC acknowledges DE's application of the proportionality principle, one should however bear in mind that the set-up of an investment firm requires time and dedication, even prior to the business starting.
61. While DE may indeed rely on ongoing supervision to ensure that a firm builds up its governance structure and resources over time depending on the development of the business, MiFID II provides<sup>28</sup> that the competent authority shall not grant authorisation unless and until such time as it is fully satisfied that the applicant complies with all requirements under the provisions adopted pursuant to MiFID II. This principle is reiterated in the General Opinion<sup>29</sup> and in the IF Opinion.<sup>30</sup>
62. In addition, the PRC deems that the alternative arrangements accepted by BaFin under Article 9(6) of MiFID II did not appear to ensure the sound and prudent management of such investment firm and the adequate consideration of the interest of clients and the integrity of the market.
63. Although the conditions and consequences of Brexit were uncertain for some time, the above principles still applied and applicants should not have been allowed to establish "just-in-case" firms.
64. For one NCA (CY), the PRC is concerned that it interpreted the requirements of having two persons effectively directing the firm in a flexible way by not requiring two full-time employees. The PRC understand that CY interprets the requirement of sufficient time commitment of Article 91(2) of Directive 2013/36/EU as being met when the maximum number of directorships provided in Article 91(3) and (4) are met. The PRC however considers that the requirements of Article 91(2) of Directive 2013/36/EU and Article 9(6)

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<sup>28</sup> Article 7(1) of MiFID II.

<sup>29</sup> ESMA42-110-433, paragraph 16.

<sup>30</sup> ESMA35-43-762, paragraph 10.

of MiFID II should be assessed independently. In addition, the PRC deems that the alternative arrangements accepted by CY under Article 9(6) of MiFID II did not appear to ensure the sound and prudent management of such investment firm and the adequate consideration of the interest of clients and the integrity of the market.

## **Assessment**

65. To summarise:

- a. CY: partially meeting expectations.
- b. DE: partially meeting expectations.
- c. IE: fully meeting expectations.

66. In terms of good practices, the PRC notes that:

- a. in addition to the written vetting process, two NCAs (CY, IE) also conduct interviews to varying degrees depending on the risk classification of the applicant firm, the nature of its business and/or any potential issue being identified; and
- b. one NCA (CY) conducts, for each applicant firm prior to granting authorisation, a pre-approval on-site visit during which it interviews, as a minimum, the persons effectively directing the firm as well as the compliance officer (and head of sales for CFD firms).

### **4.1.1.2 Meaningful presence in the member state of establishment**

67. The NCA should ensure that the persons effectively directing the business and other senior management and/or key function holders of applicant firms are in the member state of establishment. Whilst this principle is true for all authorisations in order to avoid regulatory arbitrage, it is particularly relevant for UK firms relocating activities to the EU in order to avoid letter box entities with no meaningful presence in the member state of establishment but managed instead from the UK.

## **Summary of findings**

68. One NCA (DE) requires that tasks of board members to be performed predominantly in its jurisdiction. The NCA indicated that a small number of applicants were initially reluctant to commit to a meaningful presence in the member state of establishment but that, in most cases, plans were amended to meet the NCA's expectations. It provided an example where they opposed to the applicant's firm proposal to have the managing directors in dual hat with roles in the UK entity, with a combined time commitment of 50 days physical presence in Germany. Following various proposals that the NCA rejected, the applicant agreed to double the time commitments of the managing directors to be present in Germany to 100 days, in addition to having a third managing director working full-time for the firm from Germany.

69. Another NCA (CY) imposed minimum requirements and criteria to ensure that the board members, individuals effectively directing the business as well as the control functions were located within the jurisdiction. These included requiring the majority of board members to be located in the member state, and a minimum of two senior management to be locally based. In addition, internal control functions, even if outsourced, had also to

be located in the jurisdiction. For CFD firms, however, the NCA required that the compliance function to be established internally, as evidenced by one of the authorisation files presented to the PRC.

70. Two examples were provided to illustrate such requirements. In the first example, the initial application included one of the two senior managers being located in Portugal. The NCA required the individual to relocate to the Republic of Cyprus. In the second example, the NCA required the applicant to appoint an additional locally based executive director, as well as establishing various control functions and back-office operations.
71. Another NCA (IE) required that the majority of the board members, of the persons effectively managing the business and key function holders of the applicant firms are locally based in Ireland. IE put special scrutiny on the people who actually manage the business and hold multiple roles in other entities (executive or non-executive). One notable exception related to the Head of Internal Audit function where, depending on the firm's nature, scale, and complexity, the provision of the internal audit function at group level across affiliates may be deemed appropriate by the NCA.
72. The NCA (IE) further required at least two Executive Directors based in Ireland and working on a full-time basis. This requirement was applied to all firms irrespective of their risk categorization. From the sample files provided, the PRC was satisfied that this was applied consistently.

### **Analysis**

73. The PRC considers that all NCAs in scope effectively enquired about the presence in the member state of establishment of the persons effectively managing the business, board members and key function holders of the applicant firm.
74. However, the PRC is concerned that, for one NCA (DE), the minimum presence requirements applied may not be meaningful as the thresholds applied were too low. Indeed, for a number of sample cases provided, it seems that that NCA accepted limited presence of managing directors in Germany during phase in periods with no specific end date set up (in one case, two out of three managing directors committed to spend only 100 days in total in Germany – for both of them).
75. In such application files, extensive outsourcing to the UK was also put in place with, for instance, the risk management officer and support still provided by the UK entity or group. As the managing director was also only intermittently present in Germany, one may question whether, in such case, the key function holder had a meaningful presence in Germany.
76. The PRC was satisfied that the other two NCAs (CY, IE) demonstrated throughout the review that they challenged firms on the location of key role holders, that the minimum presence thresholds applied were meaningful and that it required, where necessary, the relocation of key individuals or roles to their jurisdiction in advance of authorisation being granted.

### **Assessment**

77. To summarise:
  - a. CY: fully meeting expectations.





- b. DE: partially meeting expectations.
- c. IE: fully meeting expectations.

#### 4.1.1.3 Conflicts of interests

78. At authorisation stage, the NCA should ensure that the allocation of functions (in particular relating to risk-taking and independent control) within an investment firm should be organized in a manner that avoids conflicts of interest. Where firms are relocating activities from the UK to the EU due to Brexit, the risks of such conflicts of interests increase as applicants may seek to maximise synergies between the new EU entity and the UK entity and/or other existing entities within the group without paying sufficient attention to potential risks of conflicts of interest.

#### **Summary of findings**

79. All NCAs (CY, DE, IE) responded that they assessed the conflicts of interest which may occur as part of their assessment of applications of the persons effectively directing the business, members of the management body and/or key function holders of the applicant firm to ensure that links between such persons and group entities or service providers did not compromise the independence of the applicant firm.
80. One NCA (DE) stated that they considered that lack of conflicts of interests is essential in the assessment of trustworthiness of management board members, and that where a permanent conflict exists, this prevents an appointment of the person in question.
81. That NCA (DE) also reported that it did not encounter an application file in which conflicts of interests of the nature described above emerged. However, in one of the sample files provided to the PRC, it was clear that the NCA did not challenge the conflicts of interests existing due to dual hatting by two of the managing directors. In such case, two managing directors (out of three in total) were to work part-time for the German firm whilst also retaining their functions in the UK investment firm. Both managing directors were to be employed by the UK entity and seconded to the German firm, with their remuneration still determined and paid by the UK entity. The German entity was also still relying quite heavily on its UK mother entity through outsourcing. The NCA could not detail how such arrangements were challenged and how the firm could show that the conflicts of interests existing in such case were managed.
82. In addition, that NCA (DE) stated that it required the compliance function to be separate from the risk-taking function. However, firms with only one managing director may be allowed to combine the compliance function with risk-taking functions. A sample case that was discussed during the on-site visit showed a firm had one managing director who was also responsible for the compliance function. DE advised that there were exceptions to the rule permitted for smaller investment firms. However, when asked on the threshold for permitting the combining of risk-taking and control functions, the NCA advised that there were no set criteria in place but it would take into account the business model of the investment firm and if it is not intended to take any balance sheet risks, DE would allow the applicant firm to combine the compliance function with operational function. The PRC however considers that risks other than balance sheet risks may arise, which may lead to possible investor detriment. Such criteria may thus not guarantee that no conflicts of interests exist and that the compliance function remains effective. While Conflicts of Interest Policies were not reviewed in the case of all applicants, BaFin stated

that they did review the policies in instances where any doubt existed. It was emphasised that the NCA (DE) expected measures to be in place to manage conflicts at the point of commencement of operations, and not at the point of authorisation. The NCA relied on firms to advise them when they were starting business. Similarly, the NCA required that the Conflicts of Interest Policy be in place at the point of the start of the business rather than at the point of authorisation. As such, it is not clear how DE could ascertain that conflicts had been appropriately mitigated or managed. While DE could request a copy of the final policy (and this may be stipulated in the licence), this only occurred in instances where doubts had been expressed regarding a particular conflict. Otherwise, reliance was again placed solely on the external auditors' report.

83. Where conditions were imposed regarding the management of conflicts of interest, these were typically done informally and were monitored during ongoing supervision through discussions in some cases, and otherwise through the annual audit. It is unclear how the NCA (DE) gained assurance that all conditions were implemented in accordance with expectations in the absence of a formal, enforceable undertaking.
84. Another NCA (IE) stressed that, although each application file is assessed through the lens of the proportionality principle, according to the CBoI's Corporate Governance Code for Investment Firm's and Market Operators 2018, all firms should have a majority of independent non-executive directors. However, by derogation to this general principle, firms which are part of a group should instead comply with the following: High Impact firms should have at least three independent non-executive directors, Medium High Impact firms at least two and Medium Low Impact firms at least one. The PRC verified the application of this requirement through the review of the sample files provided.
85. Furthermore, all applicant firms are required to confirm that the board approved a conflict of interests policy, as part of the assessment of individuals applying for PCFs. Depending on the risk categorisation of the firms as well as the existence of any red flags, the NCA (IE) may review the conflict of interests policy of the firm at authorisation stage and comment on it. If performed, the review aims to ensure that links between such persons and group entities or service providers do not compromise the independence of the applicant firm nor the decision-making process.
86. IE provided an application file in which it challenged the appointment of a majority shareholder as chair of the board for a high impact firm. The NCA also responded that, although it allowed dual hatting, it required in such cases that the reporting lines and remuneration decision be with the Irish firm.
87. The NCA (IE) also noted that typically individual applicants are not allowed to hold more than one key role, but the NCA assesses this principle on a case-by-case basis according to the nature, scale and complexity of an entity and depending on the time committed to each company. The PRC team was presented with i) one authorisation file where the roles of Head of Compliance and Head of Risk were combined, at the same entity, on a permanent basis and ii) another case where, for a period of 6 months, the same individual was allowed to perform the two functions until the firm hired a full-time Head of Compliance and a full-time Head of Risk.
88. Another NCA (CY) provided an example, whereby links were identified between board members and group entities which were to be appointed as service providers. The NCA required the firm to justify how it had put in place appropriate mechanisms to manage

the conflicts that existed, and the firm removed its reliance on group internal audit, instead appointing a Big four audit firm within the jurisdiction.

89. Nevertheless, the sample cases provided by CY contained clear examples of conflicts of interest. In one of the sample files provided (a CFD firm), two of the executive directors were also directors of the UK group entity. Also, the NCA addressed some of the conflicts of interests that were apparent in such situation, some persisted and were not remedied (the Cypriot firm was also outsourcing activities to the UK entity, so a clear conflict remained whereby the same individual was executive director of both the Cypriot firm and the entity that it outsourced to). In another file provided to the PRC, it seems that CY did not address some potential conflicts of interests between the group and clients of the firm resulting from the combination of the group structure, the nature of the activities of the applicant firm and its governance structure.

### Analysis

90. For one NCA (IE), the PRC was satisfied that, for high impact firms, the conflicts of interests which may occur as part of its assessment of applications of the persons effectively directing the business, members of the management body and/or key function holders of the applicant firm were assessed in order to ensure that links between such persons and group entities or service providers do not compromise the independence of the applicant firm. For other firms though, the PRC noted that, although the NCA ensured the applicant had a conflicts of interest policy in place, it did not necessarily review such policy.
91. To the contrary, the PRC is concerned that for the other two NCAs (CY, DE), on the basis of the sample files provided, it appeared that not all potential conflicts of interests were addressed. In one case (DE), potential conflicts of interests emerged from dual hatting by two of the executive directors (with the UK entity) and resulting in a potential lack of independence of the applicant firm. For the other NCA (CY), conflicts of interests arising (i) from links between senior management and group service providers were not addressed at authorisation stage as well as (ii) from the combination of the governance structure and the nature of the activities in the group were, in the PRC's view, not sufficiently addressed by the NCA.
92. The PRC further considers that, in accordance with the IF Opinion<sup>31</sup>, NCAs should analyse firms' conflicts of interest policies and procedures in order to be satisfied about the effective management of conflicts of interests, for all firms. The PRC is even more concerned by one NCA (DE) granting authorisation to applicant firms without ensuring in all cases that a conflicts of interest policy is in place.
93. Lastly, regarding internal control functions specifically, the PRC is concerned that all NCAs may have allowed too frequently, either on a temporary or on a permanent basis, for the same individual to hold several functions (between two internal control functions and/or with operational functions), which may create conflicts of interests and affect the effectiveness of such functions. From the files reviewed and the on-site visit, it was unclear whether the NCAs further looked into potential conflicts of interests and safeguards in such instances, in addition to being satisfied that the scale of the firm justified such combinations (as required under MiFID II).

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<sup>31</sup> ESMA35-43-762, paragraph 35.

## Assessment

94. To summarise:
- a. CY: partially meeting expectations.
  - b. DE: partially meeting expectations.
  - c. IE: largely meeting expectations.

### 4.1.1.4 Resources

95. The NCA should receive detailed information and be satisfied that sufficient human and technical resources are available to each senior manager and/or key function holder enabling them to effectively discharge their roles from the date of the authorisation. Again, in the Brexit context, this was particularly relevant to avoid letter box entities created to access the European market whilst the firm was still mostly governed and controlled (referring here to the control functions) from the UK.

## Summary of findings

96. For the review period, one (IE) out of the three NCAs did not authorise firms where the governance structure was limited to the minimum two members of the management body.
97. One of the other two NCAs (DE) indicated that, in accordance with the German national implementation of Article 9(6) of MiFID II,<sup>32</sup> investment firms that are authorised to obtain ownership or possession of funds or securities of clients and/or that trade on own account must have at least two sufficiently qualified managers. However, for other firms, only one person effectively managing the business is sufficient provided that i) managers can prove sufficient knowledge and competence as well as sufficient time to perform duties adequately; and ii) adequate proxy arrangements are in place. In this respect, the NCA (DE) reported that out of 25 application files where applicant firms could have presented only one managing director, most provided for two managing directors when presenting their application, with only seven applicants relying on only one managing director.<sup>33</sup> The NCA specified that this approach (allowing only one managing director) is not Brexit-related but results from the German national implementation of MiFID II.
98. In the sample files presented by the NCA (DE), proxy arrangements that were determined by the NCA as adequate, and therefore allowed the firm to rely only on having just one managing director, included: i) the establishment of an advisory board composed of two members which committed to allocate eight (8) days per year each to their function as part of the advisory board and ii) a substitute managing director, which were to be available if the principal managing director is not, and whose role consisted of the exclusive representation of the firm with regard to completion, change or termination of asset management contracts or similar contracts with costumers or completion, termination or change of other contracts or documents in relation with the usual business of the firm.

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<sup>32</sup> Section 33(1) No.5 German Banking Act (KWG).

<sup>33</sup> Of these 7 authorisations, only 5 firms had one managing director at the time of commencing their operations and only 4 still have one managing director today.

99. For another NCA (CY), as set out above in paragraph 54, the alternative arrangements accepted by the NCA under Article 9(6) of MiFID II did not appear to ensure the sound and prudent management of such investment firm and the adequate consideration of the interest of clients and the integrity of the market.
100. All NCAs (CY, DE, IE) indicated that they ensured applicant firms had sufficient human and technical resources available to each senior manager and/or key function holder to enable them to effectively discharge their roles.
101. For one NCA (DE), however, in the sample cases provided pertaining to small firms, applicants were allowed to start business with only one or two managing directors and no staff or one staff and outsourcing arrangements to the UK, including for support provided to key control functions.
102. As set out above, this NCA (DE) may, especially for smaller firms, accept that the applicant builds resources in Germany after the granting of the authorisation. In such case, the NCA would rely on its ongoing supervision, although they specified that no specific comments were addressed to external auditors in this respect nor were the mandates of external auditors amended. The NCA indicated that the follow-up was rather based on an informal undertaking (through written correspondence between the NCA and the applicant firm and was not reflected in the authorisation letter) and that, based on experience, firms always complied with the informal conditions discussed at authorisation stage.
103. One NCA (IE) also required that all organisational positions (board members, senior management as well as internal control functions) were filled at authorisation stage. As part of the sample files provided, the PRC was shown evidence that the NCA ensured that senior management and internal control functions had enough support. The NCA required that all the firms it supervises provides a monthly report including metrics relating to the number of staff working for the firm. For significant firms, the NCA may choose to ask for more frequent reports. In one of the authorisation files that the PRC could review, since the applicant firm was of a very significant scale, the NCA required, although for a limited period of time after the authorisation was granted, for weekly reports in order to monitor, inter alia, the number of staff working for the firm and whether they were proceeding to hire the number of staff foreseen during the authorisation process.
104. In addition, such NCA (IE) included in the authorisation letter a condition whereby authorised firms had to submit an application for material change under Article 21(2) of MiFID II when there was any deviation from the firm's programme of operations of a magnitude equal to or higher than 40% of the projected number of clients or level of activity.
105. Again, for small firms, two NCAs (CY, DE) allowed senior managers as well as key function holders to combine their functions with similar functions in other entities and/or with other functions in the same entity, with no further support.
106. However, one of the two NCAs (CY) includes as a condition in its authorisation letter, for all firms, that any increase in the firm's revenues by more than 20% from one year to the other should trigger a review of the adequacy of the firm's internal control functions and their strengthening and that the NCA should be informed.

## Analysis

107. The PRC is concerned that one NCA (DE) authorised applicant firms with just one person effectively directing the business and with alternative arrangements that the PRC sees as insufficient to ensure the sound and prudent management of such applicant firms and the adequate consideration of the interest of clients and the integrity of the market. The issue was observed in relation to small applicant firms but not in larger firms.
108. Furthermore, the PRC is concerned that this NCA (DE) is interpreting the exception under Article 9(6) of MiFID II (i.e. the possibility to have firms effectively directed by only one person) in a very extensive way. Under MiFID II, the rule is that firms should be effectively directed by at least two persons, and can only be managed, on an exceptional basis by one person, if a number of conditions are being met. However, as described above in paragraph 9797, the rules for firms submitting their applications to this NCA is that a firm may be managed by only one person unless it is authorised to obtain ownership or possession of funds or securities of clients and/or it deals on own account. The “reversed logic” of the legislation seems reinforced by the low thresholds applied by the NCA in relation to the alternative arrangements (under Article 9(6) of MiFID II) that a firm should put in place when having only one person effectively directing its business.
109. For another NCA (CY), the PRC is of the view that, at least in one case, the time commitment of senior managers and other staff, including key function holders, did not guarantee that senior managers and key function holders were in a position to effectively discharge their roles.
110. The above concerns are, however, limited to applications for authorisation submitted by small firms with non-complex activities. For more significant firms and those with more complex activities, the PRC is satisfied that the NCAs in scope ensured that applicant firms had sufficient human and technical resources available to each senior manager and/or key function holder to enable them to effectively discharge their roles, although such resources were sometimes excessively provided through intra-group outsourcing arrangements which may also be problematic (please see section on outsourcing below).
111. The PRC however noted that one NCA (IE) took a less stringent approach to authorisation regarding branches of UK entities which had been established for a long time in its jurisdiction and became subsidiaries to relocate activities to the EU due to Brexit. The cases presented were for low impact and medium-low impact firms and the NCA granted authorisations with conditions and phase-in periods for the bolstering of resources. This NCA, however, only granted phase-in periods with specific and enforceable deadlines and followed up on them.
112. For the other two NCAs (CY, DE), the PRC is further concerned by authorisations granted subject to conditions and phase-in periods for the relocation of staff in-house and in the member state of establishment. For one NCA (CY), the PRC however notes that the flexibility allowed was limited to support functions and subject to specific and enforceable deadlines. Follow-up was however left to on-going supervision and it was unclear whether this was done systematically. For the other NCA (DE), authorisations were granted with significant phase-in periods permitted for the establishment of optimal organisational structures, including resources. The employment of lengthy phase-in periods gives rise to a risk that firms may be operating with inappropriate structures, including insufficient staff, in place for a prolonged period and may have an over-reliance on the group. In addition, the ability of the NCA to monitor the transition from such interim arrangement to the permanent organisational structure was diminished by its reliance on external auditors only and by its informal form.

113. The PRC is of the view that transitional arrangements in place after the authorisation stage (where they give a firm some flexibility regarding a MiFID requirement) should be limited and, in any case, avoided from the moment the firm starts its activities (i.e. providing services to clients).
114. For two NCAs (CY, IE), the PRC noted as a good practice that they included in the authorisation letter the obligation for firms to liaise with the NCA if their activities increase by more than a certain percentage (from the projections submitted in their business plan or from year to the other). In one case (CY), this applies only to internal control function resources. In the other case (IE), this applies to the resources of the firm in general and thus also encompasses key function holders and senior managers.
115. The PRC also positively notes that one NCA (CY) carried out an on-site inspection at the authorisation stage and that the topic of the resources dedicated to the planned activities was addressed as part of such inspection.

## **Assessment**

116. To summarise:
  - a. CY: partially meeting expectations.
  - b. DE: partially meeting expectations.
  - c. IE: fully meeting expectations.

In terms of good practices, the PRC notes that two NCAs included in the authorisation letter the obligation for firms to liaise with the NCA if their activities increase by more than a certain percentage (from the projections submitted in their business plan or from year to the other).

### **4.1.2 Substance requirements**

#### **4.1.2.1 Choice of member state of relocation**

117. In accordance with Recital 46 of MiFID II and as further developed in paragraph 12 of the IF Opinion, the NCA should assess applications in order to ensure that the choice of member state for relocation is driven by objective factors (and not by regulatory arbitrage). Thus, the NCA should carefully assess the geographical distribution of activities of the applicant (based on e.g. the programme of operations, information on prospective investors, marketing and promotional arrangements, location of development of products or services, the identity and geographical localization of distributors' activities, language of offering/promotional materials) and should not grant authorisations where the applicant has opted for a jurisdiction for the purpose of evading stricter standards in another member state within the territory of which the firm intends to carry out or carries out the greater part of its activities.

## **Summary of findings**

118. All NCAs (CY, DE, IE) enquired about the reasons behind the choice of member state of establishment.

119. All NCAs (CY, DE, IE) indicated that they accepted applications where the activities of the firm were distributed across EU member states and where the greater part of the firm's activities were not located in one particular jurisdiction. Reasons listed by applicants to choose such jurisdictions include: the jurisdiction is a financial hub, English-speaking, knowledgeable and skilled staff is available for hire, this is an attractive place to live.
120. For one of the two NCAs (IE), the PRC noted that for one of the largest (in terms of clients) applicant firms only 1% of the clients to be relocated would be residing in Ireland, whereas, 40% of its clients were residing in Germany. The NCA considered this as acceptable based on the argument that this did not amount to more than 50% of the clients of the firm in one member state. Further, such applicant had primarily introduced its application in a different jurisdiction but, due to limits imposed by that NCA (cap on the overall number of clients), the firm had then decided to introduce a second application in Ireland.
121. For another NCA (CY), the PRC noted that in two instances, firms introduced authorisation applications in Cyprus in parallel to applications they already had introduced in other member states. The introduction of a new authorisation application in Cyprus was triggered, in one case, by the time it took for an existing application to proceed in a different jurisdiction and, for the other case, a decision by the applicant to focus on its establishment in Cyprus instead.
122. Two NCAs (CY, IE) indicated that they made some changes to their authorisation procedure to take Brexit into account.
123. One of them (IE) reported that it adapted its existing authorisation procedure in order to understand the rationale for selecting its jurisdiction as home member state. As such, extra questions were included in the application form requesting (i) a full geographical breakdown of clients and client assets, (ii) number of FTE employees (and whether they are shared with other group entities), (iii) services provided through affiliate agreements or outsourcing arrangements (with a special scrutiny on UK outsourcing), and (iv) whether the investment firm is adopting online business models (e.g. brokerage and marketing). The NCA indicated that it also adapted its MiFID Guidance.
124. The other NCA (CY) indicated that it changed its authorisation procedures regarding firm's seeking authorisation due to Brexit in order to ensure compliance with the IF Opinion – besides the MiFID II framework. In addition, in 2019, such NCA adopted a special internal guidance (IG080), and a full (internal) report addressing all issues raised during SCN meetings. Regarding the choice of member state of relocation, it ensured that this was assessed through business plans, where they specifically asked for information of geographical distribution and activities. If no such information was provided, further inquiries were conducted by the NCA. It also assessed information regarding the location of prospective investors, marketing and promotional arrangements, location for development of products and services, language of offering/promotional materials.
125. Finally, the other NCA (DE) indicated that there was no change to its authorisation procedure regarding applicant firm's seeking authorisation due to Brexit. Nonetheless, it ensured that information regarding the choice of its jurisdiction for relocation was assessed according to the MiFID II framework, namely on the basis of the geographical distribution and the cross border planned activities.





## Analysis

126. The PRC positively notes that all NCAs enquired about applicant firms' reasons for the choice of their jurisdiction as the applicant firm's member state of establishment, mostly focusing on the geographical distribution of the target clients and planned activities. The PRC also notes that two NCAs (CY, IE) indicated that they also accepted other objective reasons (besides the geographical distribution of activities) for the choice of the member state of establishment notably that their jurisdiction constitutes a financial hub, which is not contrary to the single market and freedom of establishment established under MiFID II.

## Assessment

127. To summarise:

- a. CY: fully meeting expectations.
- b. DE: fully meeting expectations.
- c. IE: fully meeting expectations.

### 4.1.2.2 Resources

128. The NCA should ensure that the applicant firm's financial and non-financial resources are appropriate in relation to the activities the firm intends to carry out. This is to ensure that, in the Brexit context, UK entities do not create letter box entities in order to access the European market whilst most of the services and activities are still mostly performed from the UK.

## Summary of findings

129. All NCAs (CY, DE, IE) enquired about the applicant firm's financial and non-financial resources in order to ensure that they are appropriate in relation to the activities the firm intends to carry out.

130. One NCA (DE) reported that it based its assessment on the organisational chart of the applicants (containing FTE for each organisational unit) against the background of the planned number of clients and the business model (the assessment was made according to its "Minimum Requirements for Risk Assessment" – MaRisk<sup>34</sup>). Such NCA indicated that it didn't require applicant firms to fulfil all governance and substance requirements from day one. Due to the special situation of Brexit and its transition period (and also to the global pandemic), some requirements were subject to a phase-in period, "most notably the presence of certain key function holders" – and other human resources.

131. For instance, the NCA (DE) granted one applicant firm a three-year phase-in period to build up its in-house risk management capabilities and end its 100% back-to-back booking model. It also relied on informal undertakings with firms that they would build up their resources over time and depending on the development of the business. However, as reported above in the governance section, in certain cases (small firms), the resources of the firm seemed very sparse, putting in question the ability of the entity to

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<sup>34</sup> BaFin - Circulars - Minimum Requirements for Risk Management.

properly carry out its activities. A second NCA (IE) reported that it ensured that applicant firms had sufficient human and technical resources for the scale and complexity of the planned activities based on the outset assessment of its Probability Risk and Impact System (PRISM impact risk rating). This NCA may also grant transitional arrangements regarding resources, it, however, follows up through, notably, the monthly reporting (including number of FTEs) that all firms have to submit to the NCA. The NCA then relies on ongoing supervision and the level of scrutiny put on the firm depends on the PRISM categorisation of the firm. The PRC was shown evidence that authorised entities had to comply with the provisions of an authorisation immediately, from day one, although some could have a timeline and a finite span for full complement of resourcing. These conditions were appended to the letter granting the authorisation.

132. In addition, as previously mentioned in paragraph 104104, that NCA (IE) includes in the authorisation letter a condition whereby authorised firms have to submit an application for material change under Article 21(2) of MiFID II where there is any deviation from the firm's programme of operations of a magnitude equal to or higher than 40% of the projected number of clients or level of activity.
133. To ensure that applicant firms had sufficient human and technical resources, the third NCA (CY) based its assessment on the nature, scale, complexity of the applicant firm and the outset assessment of the NCA's risk-based approach (RBS-F). At the authorisation stage, such NCA carries out a first on-site inspection to assess compliance with substance requirements and assesses the business plan of the applicants and the sustainability of their business model in order to ensure that the applicant firms' shareholders have financial resources to support the applicant firm's costs for the first three years. The sustainability of the business model and business plan were assessed based on financial projections. In addition, this NCA indicated that it required that all organisational positions were required to be in place prior to commencement of operations. Outsourcing arrangements were also required to be established in advance, and an audit trail was required to evidence the existence of effective control mechanisms.
134. However, for small firms, it seems that this NCA (CY) was granting authorisations with some limited human resources in several areas: senior management, internal control functions as well as very little staff providing the core investment services (investment advice).
135. This NCA (CY) however carried out on-site inspections at the authorisation stage and the topic of the resources dedicated to the planned activities was addressed as part of such inspections. In addition, as previously mentioned above in paragraph 106106, in the authorisation letter, such NCA requires that firms should strengthen their internal control functions and inform the NCA when they increase their revenues by more than 20% from one year to the other.
136. Out of the three NCAs, only one (IE) indicated that it compared the number of staff and other resources that the applicant firms intended to dedicate to the relocated activities compared to the resources allocated to the same activities when they were located in the UK, but only as an aid for reviewing the application based on its own merits. One (DE) of the two NCAs that were not using this factor indicated that this was due to the fact that, in most cases, there were no plans to relocate the same business from the UK firm to the new firm in its jurisdiction. The other NCA (CY) indicated that it did not compare the number of staffing and other resources and activities the applicant firms intended to dedicate to the relocated activities with the resources and activities they had

in the UK, even when the applicant had more clients in other jurisdictions than in the Republic of Cyprus. Although it is a standard procedure for the NCA (CY) to demand for further information and/or consult other competent authorities where the firm is currently, or has previously been, regulated by that authority, the NCA stated that its evaluation of the relocation process was totally independent and solely based on the applicant's procedure, e.g., the business model, the organisational chart and the planned number of clients.

## **Analysis**

137. The PRC is satisfied that all NCAs enquired about the applicant firms' resources (financial and non-financial) dedicated to the planned activities.
138. The PRC also positively notes that one NCA (CY) carries out on-site inspections at the authorisation stage and that the topic of the resources dedicated to the planned activities was addressed as part of such inspections.
139. For two NCAs (CY, IE), the PRC notes as a good practice that they include in the authorisation letter the obligation for firms to liaise with the NCA and strengthen their internal control functions if their activities increase by more than a certain percentage from the projections submitted in their business plan.
140. For all NCAs, the PRC is concerned by the authorisations granted subject to conditions and phase-in periods for the relocation and hiring of staff. However, the PRC notes that one NCA (IE) granted authorisations with transitional arrangements regarding staff as part of the phase-in approach to the relocation of activities and clients of the firm (i.e. not all clients migrated to the new investment firm on day one of the authorisation). In this way, this NCA prevented the creation of letter-box entities by setting specific conditions in the authorisation letters which were only valid for short time spans, and by following up (as part of the ongoing supervision) through the monthly and quarterly metrics reporting all firms are subject to. For another NCA (CY) the PRC notes that the flexibility allowed was limited to support functions and subject to specific and enforceable deadlines. Follow-up was however left to on-going supervision and it was unclear whether this was done systematically. For the third NCA (DE), transitional arrangements were granted for firms to fulfil certain staffing requirements. For small firms, the PRC is concerned by the length and scope of the phase-in periods granted to fulfil certain staffing requirements. In addition, the PRC would recommend that the informal undertakings on which such NCA relied to ensure that firms had built up their resources over time was more formally established and followed up.
141. The PRC is of the view that transitional arrangements in place after the authorisation stage (where they give a firm some flexibility regarding a MiFID requirement) should be limited and, in any case, avoided from the moment the firm starts its activities (i.e. providing services to clients).
142. For small firms, the PRC is also concerned by the little substance sometimes allowed to be set up in house by two NCAs (CY, DE). In the case of DE, small firms were relying instead on intra-group outsourcing.

## **Assessment**

143. To summarise:

- a. CY: partially meeting expectations.
- b. DE: partially meeting expectations.
- c. IE: Largely meeting expectations.

144. In terms of good practices, the PRC notes that:

- a. one NCA (CY) carries out on-site inspections at the authorisation stage and that the topic of the resources dedicated to the planned activities was addressed as part of such inspection.
- b. two NCAs (CY, IE) include in the authorisation letter the obligation for firms to liaise with the NCA if their activities increase by more than a certain percentage from the projections submitted in their business plan.

#### 4.1.2.3 Outsourcing

145. The PRC assessed whether the NCA ensured that outsourcing does not impact the substance and the independence of the firm, in particular that: i) it does not result in the delegation by senior management of its responsibility, ii) it does not alter the relationship and obligations of the firm towards its clients, iii) it does not undermine the conditions of authorisation the firm must comply with under MiFID II and iv) it does not breach any of the conditions subject to which the firm's authorisation was granted. It is also important that the NCA is satisfied that outsourcing does not create operational risks and does not impair the quality and independence of its firms' activities and internal controls or their ability or that of the NCA to supervise compliance with regulatory requirements.

#### **Summary of findings**

- 146. All NCAs (CY, DE, IE) reviewed applicant firms' planned outsourcing arrangements to ensure that there were objective reasons for the outsourcing and delegation arrangements and they did not lead to the creation of letter-box entities or allow for the circumvention of the MiFID II framework.
- 147. One NCA (CY) reported evaluating the outsourcing and delegation arrangements of applicant firms to ensure that the core functions were conducted internally (operational units and key control functions – compliance, AML, risk, internal audit) or, where the applicant had outsourcing arrangements planned, that the applicant had established procedures for the oversight of the outsourced activities. However, such NCA (CY) indicated that it does not ensure that the applicant firm carried out an analysis of the expected benefits of the envisaged outsourcing arrangements. In addition, such NCA (CY) indicated that it did not allow the outsourcing of the compliance function for all CFD entities and AML compliance for all entities. For CFD firms, other internal control functions could be outsourced but had to be carried out locally in Cyprus.
- 148. Another NCA (IE) reported that for all applicants but in particular Brexit entities, it assessed the outsourcing arrangements in accordance with the EBA Guidelines on outsourcing arrangements. Such NCA ensured that all outsourcing arrangements were probed with a particular focus on UK outsourcing and proposals/requests for core MiFID activities to remain in the UK. Lastly, such NCA (IE) indicated that it was however mindful to ensure that no operational risk was introduced by insisting on the transfer of activities

from where the human or technical infrastructure was currently relied upon other affiliates.

149. Based on the discussions during the on-site visit, the PRC understood that authorisations have been granted with extensive outsourcing arrangements in place. However, the PRC was satisfied that outsourcing arrangements did not allow for the core services or activities to be provided from the third-party provider (instead staff from third party providers provided support to the firm's in-house personnel providing the substance of the services).
150. Where the number of in-house staff was smaller than staff from third party providers working for the firm, the NCA (IE) explained that this was, for instance, due to round the clock customer support (with customer service centres established in different parts of the world) and staff being counted as working for the firm also could be shared with other entities of the group and thus worked only part-time for the firm.
151. Finally, the other NCA (DE) reported that it ensured the compliance of planned outsourcing arrangements with the IF Opinion and with its MaRisk, allowing an overview of the degree of outsourcing the applicant was planning, the expected benefits and the objective reasons for it. For this NCA, the most important aspect of outsourcing was that the local managing directors kept control over the outsourced functions. This was ensured by the definition of clear responsibilities for the outsourced functions and in most cases the implementation of an outsourcing control officer.
152. However, for small firms, that NCA (DE) sometimes accepted substantial outsourcing being done to intra-group entities (especially UK entities) with very little staff in Germany. It is, in addition, not clear how the resulting conflicts of interests were challenged by the NCA and managed by the applicant firms.
153. Regarding outsourcing to non-EU entities, all NCAs (CY, DE, IE) ensured that the relevant outsourcing arrangements did not render the applicant firm's oversight and supervision more difficult, and the measures put in place by the applicant firm to mitigate this. One NCA (DE) indicated that the applicable legal framework provides for certain mandatory requirements for the content of outsourcing contracts for significant outsourcing arrangements. One of these requirements is that the outsourcing contract guarantees the right of the NCA to receive information and to conduct inspections with regard to the outsourced activities.
154. Another NCA (CY) indicated that it takes into account (i) the jurisdiction of the third party provider (whether it is included in the high risk countries for AML purposes, whether there is a cooperation agreement in place between CY and the respective competent authority, etc), (ii) the regulatory status of the third party provider (whether it is licensed and subject to prudential supervision) and (iii) the measures taken by the applicant firm to supervise the outsourced activities.
155. Regarding outsourcing to group entities, one NCA (DE) indicated that it generally checked whether there were objective reasons for outsourcing and that conflicts of interest could be excluded but that it adopted a risk-based approach and abstained from checking every specific group entity in detail. In addition, for mitigation measures put in place by the applicant firm, as the relevant intra-group entities were mostly FCA supervised firms, the NCA (DE) also chose a risk-based approach. In this respect, another NCA (CY) indicated that, despite the additional conflicts of interests the situation could entail, it did not scrutinise further the reasons for outsourcing to group entities.

156. Lastly, the PRC noted that all NCAs (CY, DE, IE) reviewed outsourcing agreements, however adopting a risk-based approach. For one NCA (IE), for high impact firms (but only for them), such review extended to service level agreements and was extensive as it included the NCA recommending a number of amendments to the relevant agreements.

## **Analysis**

157. The PRC is satisfied that all NCAs (CY, DE, IE) put a special emphasis on the outsourcing arrangements envisaged by applicant firms wishing to relocate activities from the UK.

158. The PRC also positively notes that one NCA (CY) was particularly attentive to the outsourcing of internal control functions.

159. However, the PRC is concerned by the approach of one NCA (IE) that indicated that it was mindful to ensure that no operational risk was introduced by insisting on the transfer of activities from where the human or technical infrastructure was currently relied upon for other affiliates. Indeed, such approach, if applied extensively, could lead to the bulk of the functions of the applicant firms being kept in the UK. However, although some extensive outsourcing arrangements were allowed by the NCA, the PRC was satisfied that such NCA ensured that the core activities were performed by in-house staff, with support from third party providers (in many cases, by intra-group entities).

160. The PRC noted that one NCA (DE) accepted, for small firms, extensive outsourcing arrangements with very little staff located in-house in Germany, thereby putting into question whether more functions were actually performed from the UK which, according to the IF Opinion should not be accepted<sup>35</sup>.

161. In addition, whilst the PRC acknowledges that the provision of services within the group may provide many benefits from the point of view of efficiency and sharing of expertise, the PRC was concerned about one NCA (CY) indicating that it did not specifically scrutinise outsourcing arrangements to group entities despite such arrangements being susceptible of leading to enhanced conflicts of interests. Although, as indicated above, that NCA sometimes authorised smaller firms with very little substance, this did not translate in particularly extensive outsourcing arrangements. Lastly, the PRC was concerned by the fact that, in some sample files where applicants were granted the use of cumulative outsourcing arrangements to non-EU entities, one NCA (DE) did not require the outsourcing agreements to be in place at the moment of the authorisation nor had a formal follow-up process to ensure that they were in place at the commencement of operations, did not review them nor required a detailed plan to the phasing-out of some or any of such arrangements.

## **Assessment**

162. To summarise:

- a. CY: partially meeting expectations.
- b. DE: partially meeting expectations.

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<sup>35</sup> ESMA35-43-762, paragraph 43.



c. IE: Largely meeting expectations.

#### 4.1.2.4 Independence of internal control functions

163. Where investment firms are part of a group, the NCA should make sure that any reporting lines to the group do not impair the independence of internal control functions. This is particularly relevant in the Brexit context as risks of conflicts of interests arising from outsourcing to group entities is accrued. It is thus even more essential to have sufficiently staffed and independent internal control functions.

#### Summary of findings

164. One NCA (CY) applied certain red lines in order to ensure independence of the local firm and independence of the members of the board from the parent undertaking. These red lines were: (i) the existence of two independent non-executive directors and (ii) the existence of two full-time executive directors (four eyes) located in its jurisdiction and which should not relate with the other entities of the Group. However, the review of the sample files showed that this principle was not applied to all firms as the NCA accepted some executive directors to be working for the firm on a part-time basis and/or to be combining their executive directorship with other functions within the same firm. In addition, the sample files also showed that the NCA accepted two out of three executive directors to be also related to other entities in the group through functions held in such entities.
165. To ensure the independence of the control functions, the NCA (CY) also reported that, for CFD firms, it required the applicant firm to establish the compliance function internally and to appoint a compliance officer locally, who reports directly to the board of directors (i.e. for non-CFD firms, where the compliance function may be outsourced, but it should be outsourced locally in Cyprus). Furthermore, the NCA indicated that it required applicant firms to establish a Risk Management Committee chaired by one of the independent non-executive Directors.
166. In addition, the PRC noted that, in some of the sample files reviewed, the NCA (CY) sometimes allowed internal control function roles to be held in conjunction with operational functions, especially executive directorships.
167. A second NCA (IE) required all applicants (BAU and Brexit) to have as a minimum a locally based second line of defence function, adequately resourced and entirely independent from the first line operational activities.
168. The third NCA (DE) indicated that firms should seek a business organisation in which control functions were sufficiently segregated. Linking the compliance function at the same level to other control units, such as money laundering prevention or risk control, is however allowed if this does not undermine the effectiveness and independence of the compliance function. Any combination must be documented in a verifiable manner, indicating the reasons for the combination.
169. Again, for small firms, it seems from the sample files that conflicts of interests not sufficiently addressed and due to dual hatting compromised the independence of the internal control functions.

#### Analysis

170. Where an applicant firm is part of a group, the PRC was satisfied that all NCAs in scope enquired about reporting lines to the group impairing the independence of internal control functions.
171. For one NCA (DE), although the PRC is satisfied that in general the NCA controlled reporting lines, however, it is concerned that, for smaller firms, it did not fully address conflicts of interests due to dual hatting that affected the independence of the internal control functions.<sup>36</sup>
172. In addition, for all NCAs (CY, DE, IE), the PRC is concerned as it is unclear whether and how NCAs looked into potential conflicts of interests and safeguards where control functions were combined together.

### Assessment

173. To summarise:
  - a. CY: partially meeting expectations.
  - b. DE: partially meeting expectations.
  - c. IE: Largely meeting expectations.

## 4.2 Peer review findings: trading venues

174. For trading venues, the PRC assessed NCA's supervisory practices in relation to the list of key regulatory requirements listed below and related to the conditions and procedures for authorisation in relation to:
  - a. organisational structures, governance arrangements and decisions-making processes<sup>37</sup>;
  - b. system resilience, risk monitoring and controls as well as rules, procedures and systems to ensure fair and orderly trading<sup>38</sup>;
  - c. access to, functioning of the system and trading process as well as rules and procedures for the admission, suspension and removal of financial instruments to/from trading<sup>39</sup>;as specified by the TV Opinion<sup>40</sup>.
175. The specific supervisory expectations were set out in the peer review Mandate and are summarised below in the introduction of each assessment area. They notably mandated the PRC to assess NCA's supervisory practices in terms of both governance and substance requirements.

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<sup>36</sup> In one case, the managing director in charge of supervising risk management and the compliance function was still employed by the UK entity, remunerated by it but seconded to the German entity.

<sup>37</sup> Articles 16 and 18 and Articles 44 to 47 of MiFID II as well as related provisions in Commission Delegated Regulation (EU) 2017/584 (RTS7), in particular Articles 3 to 6.

<sup>38</sup> Article 48 of MiFID II and related provisions in Commission Delegated Regulation (EU) 2017/584 (RTS7), in particular Articles 12, 13, 15 and 16.

<sup>39</sup> Articles 18 to 20 and 51 to 53 of MiFID II as well as Commission Delegated Regulation 2017/569 on the suspension and removal of financial instruments from trading (RTS 18) and Commission Implementing Regulation (EU) 2016/824 on the functioning of MTFs and OTFs (ITS 19), in particular Articles 2 to 4 and Articles 6 to 8.

<sup>40</sup> ESMA70-154-270.



176. In order to better understand the approach adopted by each NCA to Brexit relocations, the PRC also considered the authorisation processes that NCAs applied to trading venues seeking to relocate in their jurisdiction.
177. In particular, the PRC assessed whether (i) NCAs ensured that the choice of their member state for the relocation was driven by objective factors and not by regulatory arbitrage; (ii) the process and teams involved into the authorisation was adequate to ensure that applications for authorisation could be appropriately and diligently reviewed and processed, and (iii) the NCAs used conditional and phased-in authorisation for relocating trading venues.

### **Reasons for the choice of the member state for the relocation**

178. Regarding the motivations of the trading venues which decided to relocate part of their activities in the member states under review, NCAs explained that entities had typically a short list of possible relocation member states. The factors that were generally mentioned by these trading venues included the following: (i) attractiveness of the place of relocation both as a city and as a financial hub (e.g. pool of talents, developed infrastructures), (ii) the long history of the member state with financial markets, (iii) the geographical and cultural proximity with the UK, (iv) the good command of English, and (v) the existing financial ecosystem.
179. In this area, the three NCAs (FR, IE, NL) explained that the general motivations for relocating trading venues to their Member State were also part of their analysis. In particular, one NCA (IE) indicated that during the interactions with possible applicants (e.g. bilateral meetings), they checked that relocating firms had a genuine intention to set up business in Ireland (and not just open “letter box entities”) and also more generally that relocating staff had the “heart and mind” in Ireland (i.e. local presence and time commitment dedicated to the Irish entity). Another NCA (FR) explained that they paid particular attention to this aspect during the authorisation procedure and checked that the choice was also in line with the entities’ general business and clients. The third NCA (NL) also considered the reasons invoked by possible applicants for relocating to the Netherlands during their pre-application meetings and also had discussions with other NCAs to ensure more consistency regarding the obligations imposed to potential applicants.
180. The on-site visits and meetings with stakeholders also showed that some countries (such as FR and NL) had been more forthcoming vis-à-vis possible candidates to relocation promoting their jurisdictions. It should however be noted that these promoting actions were not undertaken by the NCAs<sup>41</sup>. The PRC also would like to stress though that these practices do not constitute regulatory arbitrage<sup>42</sup> and that the approach was rather to provide administrative and material support to possible relocating trading venues.
181. One stakeholder also explained that the change of fee structure by one NCA (NL) had been also an important element of choice for them. The NCA (NL) explained that their fee structure, which was designed for a single-operator (based on the number of transaction), was changed<sup>43</sup> for a revenue-based fee in order to account for the vastly

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<sup>41</sup> For instance, in the Netherlands, the Netherlands Foreign Investment Agency reached out to certain market participants to present the Netherlands and try to attract relocating trading venues. The NFIA has no formal or informal relationship with AFM.

<sup>42</sup> See for instance paragraph 6 of the TV Opinion.

<sup>43</sup> It should be noted that the revision of the fee structure was formally not a decision from AFM but the Dutch Ministry of Finance.

changed trading venue population in the Netherlands. The previous fee structure was not really designed for non-equity trading venues. In addition, under the previous fee model, one relocating trading venue would have notably absorbed most of that NCA (NL) fees for trading venues. The NCA explained that this change increased the projected fees for both relocating and pre-existing non-equity trading venues<sup>44</sup>.

182. All three NCAs (FR, IE, NL) appeared to have relied on the reasons given by the relocating trading venues regarding the choice of their jurisdiction without challenging their choice based on the geographical distribution of their activities. It is true that for trading venues, members and participants are often spread out through the EU and the choice of a specific country is, as it emerged from interactions with stakeholders, related to other factors (see above)<sup>45</sup>. Some NCAs also did not check whether relocating trading venues had submitted other demands or been in contact with other NCAs<sup>46</sup>. One NCA (NL) confirmed that on their side they systematically asked possible applicants about other jurisdictions they were considering for their relocation to the EU.

### Process of authorisation

183. The responsibility for authorisation of trading venues varies for each NCA under review, with a different involvement of other national authorities in the process of authorisation. In particular:
- a. in France, both AMF and ACPR are involved, with the latter formally granting the authorisation for MTFs and OTFs; ACPR's role is focused on general aspects of the authorisation procedure, such as the robustness of financial forecast, the governance structures of relocating trading venues to ensure that they could operate independently from the group they belong to, as well as on issues relating to system resilience and business continuity; AMF approves the program of operation of investment firms included operators of trading venues and ACPR grants the authorisation; AMF approves also the market rules of the trading venues;
  - b. in Ireland, CBoI has full responsibility for the authorisation of trading venues, regardless of whether they are regulated markets, MTFs or OTFs;
  - c. in the Netherlands, this competence is shared (i) between AFM and the Dutch Ministry of Finance for regulated markets and (ii) between AFM and DNB for investment firms operating MTFs and OTFs, whereby the DNB carries out a prudential assessment of the investment firm and analysis on the shareholders.
184. Regarding the authorisation process, none of the three NCAs under review adopted Brexit-specific policies and procedures for the authorisation of relocating entities. However, all of them considered appropriate to set up a pre-authorisation phase in order to better explain the regulatory framework and the procedures for the authorisation, to communicate on their supervisory expectations as well as to gather information on the possible applicants and identify issues at an early stage. The formality of this first

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<sup>44</sup> AFM insisted on the fact that its supervisory costs for trading venues are in their view considerably higher in comparison with the other NCAs. Information is available on their website, explaining the breakdown of the supervisory fees: <https://verslaggeving.afm.nl/onze-kosten-in-perspectief/heffingen-per-toezichtgebied>

<sup>45</sup> It can be noted here that if the ESMA Opinions insist on the need for NCAs to assess the geographical distribution of clients and activities, this is more explicit for the General Opinion (e.g. paragraph 23) and the IF Opinion (e.g. paragraph 12)).

<sup>46</sup> According to paragraph 24 of the General Opinion, NCAs were expected to check whether relocating trading venues had seek for authorisation in other jurisdictions.

interaction varied across NCAs, with two NCAs (FR, IE) requiring also the completion of specific forms in parallel to the preliminary meetings organised with possible applicants<sup>47</sup>.

185. The NCAs' formal authorisation processes also showed different features both in terms of resources employed and in relation to the procedural steps envisaged.
186. As regards resources, a different level of interaction between persons and teams from different departments could be observed. In one NCA (FR), two teams were responsible for the authorisation of relocating trading venues, i.e. market infrastructures division and the market intermediaries' division. The former focused on MTFs and regulated markets while the latter on investment firms managing OTFs. There, data scientists could also be involved in the authorisation process on an ad hoc basis, but their role was generally limited to the follow-up phase (on-going supervision) allowing them to monitor the transfer of activities to France once the entity was authorised.
187. As regards another NCA (IE), the authorisation was dealt with by experienced supervisors. The NCA decided indeed to manage the increased number of authorisations demands through a reprioritisation of certain supervisory issues allowing senior supervisors to be involved into the review of authorisation requests. Other specialised teams were also involved on ad hoc basis in the process (in particular IT).
188. Finally, with regard to the third NCA (NL), two teams were mainly responsible for the authorisation of trading venues: the MiFID and investment management licensing team and the trading venues team. The first focused on the general authorisation requirements which are applicable on a cross-sectoral basis, while the second included experts in the trading venues' supervision and therefore looked more in details at the specific requirements applicable to trading venues. Both teams received support, throughout the authorisation process from colleagues from other and more specialised teams (in particular IT and Market surveillance teams), although no formalised process was established in this regard. All licenses and assessments in between (to check completeness and compliance, which usually resulted in another written request for information) were reviewed by senior staff members. Senior staff had bi-or tri-weekly meetings to discuss cases and promote consistency across applications and special consistency meetings were held with certain firms to discuss, for example, internal control functions. Also, all assessments were approved after reporting on them to the Brexit Steering Committee, which also included two NCA board members. Finally, the authorisation process was subject to a four-eye principle, with both the assessor and a reviewer reporting in the work programs on their findings (reporting separately when their views diverged).
189. In terms of procedural steps, the degree of formalisation of the process and checks to be performed seems to vary across NCAs. One NCA (IE) applied a more standardised procedure to trading venues authorisation<sup>48</sup> with a clear set of indispensable supervisory

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<sup>47</sup> In particular, for AMF, there was a pre-filing phase, consisting of both (i) the submission of a simplified application form (a document written in English and stressing out the main provisions firms will have to comply with) and (ii) a meeting with AMF/ACPR staff. CBol provided for (i) initial meetings with possible applicants to present CBol's authorisation process and the main supervisory expectations applying to firms seeking for authorisation in Ireland; (i) the submission of Key Facts Documents (KFDs) by possible applicants before the official start of the authorisation process to allow CBol to identify at a very early stage the possible issues with the applications.

<sup>48</sup> In IE CBol, the formal authorisation process is itself sequenced into different steps (several rounds of review, checkpoint meetings, interviews with key function holders, memo presented to management, etc...). In particular, the NCA uses a categorisation methodology to identify key risks attached to the business of relocating entities (focusing on the risks this business

expectations imposed on all applicants (e.g. regarding the composition of the boards), while two NCAs (FR, NL) assessed compliance with existing requirements more on case-by-case assessments (even though in practice these NCAs also endeavoured to ensure consistency between different applicants through internal coordination). In this respect, one NCA (FR) clarified that they calibrated their controls and checks based on the following criteria: the services provided by the firm (only operation of a trading venue or other investment services provided), the level of activities (number of clients/members, number of orders received), the type of trading (electronic system vs voice system), the structure of the group, the complexity of the business model, etc.

### Conditional authorisations

190. The PRC noted that all NCAs (FR, IE, NL) under review made use of so-called “conditional” and/or “phased-in” authorisations for trading venues. Two of them (FR, IE) insisted on the fact that they requested conditions to be fulfilled before the start of the operations of the relocating firms, although the checks and controls performed were different. While one of them (FR) stated that it systematically followed up on these conditions during the authorisation stage, the other (IE) rather left this to on-going supervision and assessed the need for follow up during the authorisation stage more on a case-by-case basis (e.g. based on the type of condition, the size of the relocated firms, etc...). Furthermore, both these two NCAs (FR, IE) allowed that relocating firms progressively relocated their activities and staff to the EU (i.e. phased-in relocation of staff). One NCA (NL) explained that they allowed conditional authorisation and phased-in relocation of activities to the EU. In the Netherlands, similarly to Ireland, the authorisation process did not envisage any specific formal follow up regarding authorisation conditions between the granting of the licence and the start of operation. This follow up has rather been performed in practice by the supervision team during the on-going supervision.

## 4.2.1 Governance

### 4.2.1.1 Independence of board members and senior managers

191. According to the TV Opinion, NCAs should ensure that trading venues that outsource activities remain fully responsible for discharging all of their obligations under the MiFID framework and that board members and senior managers of trading venues in the EU have effective decision-making powers in relation to compliance of the EU trading venue with Union law, including where the trading venue is part of a corporate group. The TV Opinion also sets out high expectations regarding the possibility for trading venues to outsource functions to third parties, specifically where they are located in a third country. It clarifies that any outsourcing, that results in the delegation by senior management of its responsibility, alters the relationship and obligations of the trading venue to its members and participants, or removes or significantly modifies the conditions subject to which the trading venue’s authorisation was granted, should not be allowed. Furthermore, with a view to ensure that the relocating trading venues retain a certain level of autonomy and are organised in a way enabling the orderly performance of their

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creates for investors and financial stability), in order to adjust the controls and checks performed (reinforcing them when necessary) and to define how intrusive the authorisation process should be. For trading venues, this “risk-based” approach is more marked in the supervision which takes the business model into account more but can also be used at authorisation stage to identify weaknesses and reinforce certain controls and checks.

activities in the EU, and taking inspiration from the specific obligations established in this regard under ESMA Guidelines on the management body of market operators and data reporting services providers, the TV Opinion also clarifies that key executives and senior managers of a trading venue should dedicate a sufficient amount of their time to the operation of the trading venue.

## Summary of findings

192. All NCAs (FR, IE, NL) received, before granting authorisation to relocating trading venues, a detailed description of the applicant's organisational structures. All NCAs requested information on:
- a. the number of staff allocated to the operation of the entity and their location;
  - b. seniority and responsibility of the management body, senior management and staff;
  - c. the organigram, reporting lines and decision-making processes highlighting in particular topics where decision-making relies on persons locating outside the EU;
  - d. information regarding the skills and expertise (such as CVs) of the management body, senior management and staff;
  - e. information of shared policies in case of corporate groups; and
  - f. for corporate group, information on centralised organisational structure for the performance of the core tasks of the trading venue (for instance, admission to trading of financial instruments, establishment and any subsequent changes to the rulebook).
193. On the basis of the above information, all three NCAs have conducted fit and proper checks on persons managing the business of the relocating trading venues. In one NCA (NL), this was done by a specific unit dedicated to this type of assessment, while for the other two NCAs (FR, IE) this check was performed within the same department following the general authorisation process.
194. For one NCA (NL), such analysis focused essentially on board members (and some verifications were made on so-called "policy makers" such as major shareholders, above 50% for regulated markets and 10% for MTFs/OTFs). Senior managers were not formally nor legally subject to a fit and proper review, although in practice that NCA (NL) monitored and checked that they had the necessary expertise as well as the time they expected to commit to the relocated trading venue to perform their duties. Another NCA (FR) reviewed the CV of board members, executive managers, compliance officers and staff responsible for audit, internal controls and risks. Besides this review, that NCA (FR) also granted professional licences, after fit and proper checks including an interview with an NCA jury, to the persons responsible for the surveillance of operations and the control of members/clients of the trading venue and the compliance officer. Finally, in another NCA (IE), a specific fit and proper process was applied to all board members as well as to the heads of risk and compliance. In Ireland, those are considered Pre-Approved Control Functions (PCFs), a status that triggers more in-depth checks regarding possible existing conflicts of interest (both during the authorisation and on an ongoing basis).
195. Regarding board members and senior managers, while all NCAs explained that they required, as a general principle, that both effective decision-making powers and responsibilities were maintained at the level of the local entity, only one NCA (IE) put in

place effective obligations to be fulfilled in all cases, while the others (FR, NL) applied a more case-by-case approach to this topic.

196. One NCA (IE) sets out clear obligations to be fulfilled, such as: (i) having two full-time executive directors (also board members) as well as the risk and compliance functions located in Ireland; (ii) appointing one independent non-executive chair for their board (the INED chair was not required to be located in Ireland but cannot hold other functions within the group); (iii) requiring boards to have a majority of non-executive directors<sup>49</sup>; (iv) complying with the Irish Corporate Governance Code; (v) not allowing (except in exceptional case) compliance and risk officers to work for more than one entity at the same time and to seat at the board. These obligations were communicated to potential applicants at a very early stage of the authorisation process (during the pre-authorisation meetings) and no derogation was allowed (including for smaller entities). They described their approach as a “firm-out” rather than “group-in” approach.
197. Another NCA (FR) did not impose pre-defined domestic criteria nor specific arrangements at authorisation stage and rules regarding composition of boards were rather applied on a case-by-case basis. The NCA (FR) explained that they did not prevent the nomination of a board member by a significant shareholder nor imposed boards that are only composed of independent board members as it is not specifically required under relevant EU Regulations. For them, the importance was to ensure a right balance between board members appointed by the shareholders and independent board members as required within the joint ESMA and EBA Guidelines. In practice though, the NCA (FR) requested to have one independent board member for most entities. They however stressed that this is also part of ongoing supervision to ensure that decisions from the boards remain fair and that interests of the French entity are not impaired and to monitor the general independence of the board vis-à-vis the group. Regarding senior managers, that NCA required that at least two executives are based in Paris with one dedicating 100% of his time to the French entity and being preferably fluent in French (a very minimum of 30% of time presence was imposed on the second executive for smaller trading venues and, for bigger trading venues, two full-time senior managers were requested). Moreover, Key Function Holders (i.e. market surveillance and control functions) were requested to be based in France and to dedicate 100 % of their time to the entity. As explained above, that NCA organised a specific licensing exam/interview for some of the key function holders. There were two functions requiring such a licence for trading venues: operations surveillance and members/clients’ control (in practice, these functions are often exercised by the same person, in particular within small trading venues). A third licence was required for the compliance function (not specific to trading venues). The licensing exam/interview was organised after authorisation (generally six months after) to allow concerned staff to familiarise themselves with the operation of the trading venue and related issues and typically concerned market functioning and supervision.
198. Another NCA (NL) required that one member of the board needed to be available in the office in the Netherlands at all times and that at least two persons within the board had to be appointed (see paragraph 209 for more information). No other specific requirement was imposed regarding the composition of the board and attention was instead focused on having targeted functions in the Netherlands (e.g. compliance, risk and client-oriented

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<sup>49</sup> This means that, in practice, the boards of relocating entities are typically composed of five members: two executive directors, two non-executive directors, one INED Chair.

services) and making sure that these positions were filled with staff with an appropriate level of expertise and seniority. This general objective was applied in practice with a certain level of judgement and discretion. For instance, the number of staff required to be employed by the local entity, was agreed on a case-by-case basis and depending on the specificities of the concerned relocating entity (see also the section 4.2.2.1 on human and financial resources). No specific criteria or thresholds of relevance were established in the AFM's procedures, but the NCA (NL) explained that consistency between the specific arrangements negotiated with the different relocating entities was usually ensured through regular contacts among assessors, through senior managers within the NCA and through the review of the application by the NCA's Brexit Steering Committee (composed of two relevant board members and department heads).

199. All NCAs seemed to have allowed a certain degree of dual hatting, meaning that members of the board/senior managers were allowed to also seat in the board/senior management of one of the companies belonging to the same corporate group (typically, the holding company). Two NCAs (FR, NL) did not impose specific limitations to this practice beyond the requirements and guiding principles already existing in EU legislative framework<sup>50</sup>. However, one of these NCAs (FR) reviewed the proportion of time that dual hatting board members would devote to the French entity in order to comply with the above-mentioned time commitment requirements. The other NCA (NL) encouraged high-profile executives from the group to be directly involved into the activity of relocated trading venues (even if those dedicated only a very small proportion of their time – e.g. 10% - to the relocated trading venue). The NCA explained that this gives more weight to the relocated firm within the group. Although the NCA (NL) did not accept all proposed arrangements, no clear limits were established and restrictions were only applied on a case-by-case basis taking the scale and complexity of business into account. That NCA did not allow for dual hatting for the managers responsible for the internal control functions. For another NCA (IE), dual hatting was not allowed for certain functions (typically for executive directors and compliance and risk officers) and carefully assessed for others.
200. When it comes to general organisational structures and reporting lines, the approaches taken by the three NCAs also differ. The types of checks and controls performed in practice varied indeed across authorities, specifically when it comes to centralisation of functions within corporate groups.
201. In particular, one NCA (IE) carefully reviewed organisational structures and reporting lines (including reporting lines to other entities within the group) and paid attention to having sufficient expertise within the relocated entities (e.g. IT expertise) to give them more weight and influence over the group.
202. As explained above, another NCA (NL) considered that full autonomy could not be achieved given the inherent inter-dependency of subsidiaries of international groups vis-a-vis their headquarters. They therefore allowed the group to have an influence on local policy making through various committees (e.g. risk committees) in which both the local executives and the group management seat. The NCA (NL) ensured that the board of relocating trading venues formally retained decision power regarding key issues (e.g.

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<sup>50</sup> This includes in particular in Article 9 of MiFID, the RTS 2017/584, the Articles 88 and 91 of the Directive 2013/36/UE, the Regulation 575/2013, the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU and the EBA guidelines on internal governance and the principles of the ESMA Opinions.

corporate policies) and had a formalised voting power at group level for decisions that concern the Dutch firm. The NCA verified that these powers were laid down in policies and procedures.

203. Another NCA (FR) also carefully review the organisational structures of relocating trading venues insisting on them maintaining independent decision-making processes (without delegation to the group), adequate reporting lines, oversight over control functions and local monitoring of outsourcing arrangements. Regarding conflicts of interests, they typically required two main types of measures to be set in place: (i) mitigation measures to prevent or limit possible conflicts of interests (e.g. Chinese walls) and (ii) the local monitoring of the conflicts of interests subject to detailed internal reporting (e.g. conflict of interest register). The NCA also required that executive managers have a sufficient knowledge of French legislative framework.
204. In terms of reporting lines, all three NCAs allowed external reporting for coordination purposes (so called “dotted reporting lines”) in order to ensure coherence at the level of the group. In one NCA (NL), joint committees were also authorised for similar reasons. However, although two NCAs (FR and NL) did not accept hierarchical reporting to the group, it is less clear the extent to which the other NCA (IE) allowed dual reporting lines (hierarchical reporting) to the group functions.

## Analysis

205. All NCAs reviewed information relating to the general organisational structure of the relocating entities and performed a fit and proper assessment at least at the level of the board members<sup>51</sup>. The two-step approach adopted by the one NCA (FR) i.e. assessment of CVs at authorisation stage and licensing interviews for a subset of staff six months after the start of operation, is considered as a good practice.
206. More importantly, the PRC notes that not all NCAs applied clear and pre-determined domestic criteria relating to the composition of the board. Two NCAs (FR, NL) relied mainly on the existing rules and guidance provided at EU level without establishing further criteria. The PRC welcomes in this respect the specific measures imposed by the other NCA (IE) to safeguard effective decision-making powers at the level of the relocated trading venue.
207. The PRC particularly welcomes the general approach adopted by one NCA (IE) (i.e. a “firm-out” rather than “group-in” approach), and also regards very positively that NCA’s attempt to translate this general approach into concrete measures that were applied to all firms. This includes notably the obligations they imposed regarding the composition of the board, its members and the risk and compliance functions.
208. The PRC appreciates that authorisation should take into account the nature and complexity of the activities envisaged by relocating entities. Trading venues are operating under a broad diversity of business models and operational set ups making it difficult to apply a one-size-fits-all approach. However, the PRC considers that this should not lead to a pure case-by-case approach but rather calls for a pragmatic application of well-established minimum authorisation criteria (e.g. going beyond these

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<sup>51</sup> See paragraph 34 of the TV Opinion and paragraph 15 of the IF Opinion.



criteria for certain entities). Discretion should also be framed by clear criteria and thresholds and not left solely to the assessment of authorisation officers.

209. In this regard, the PRC acknowledges that two NCAs (FR, NL) imposed minimum standards to all relocating entities. The PRC however regards the conditions imposed by one of them (NL) as the minimum that can reasonably be expected to ensure meaningful presence and avoid letter box entities<sup>52</sup>. A similar conclusion can be reached regarding the other NCA (FR) which based its case-by-case approach solely on the rules and principles contained in EU legislations without considering necessary to translate them into more concrete or specific criteria in the context of Brexit and in light of the guidance provided in the TV Opinion. The PRC notes that these rules and principles are quite general in nature and, as a matter of fact, that NCA's approach (FR) have led to authorising firms (notably one digitalised platform) with a number of staff and board members considered too limited by the PRC.
210. More concretely, the proportional measures imposed in practice on the composition of the board of some relocated trading venues appear very limited to the PRC. Boards play a key role in the decision-making processes of firms, and it is crucial to ensure that they do not only have appropriate responsibilities but that they are also composed of members which are committed to the concerned entity and that dedicate sufficient time to it<sup>53</sup>.
211. The PRC still notes relevant differences between two NCAs (FR, NL). One of them (FR) confirmed that, during their review of the received applications, they paid specific attention the independence of the relocating trading venues, the appropriateness of organisational structures or the prevention of conflicts of interests. That NCA (FR) therefore imposed, on a case-by-case basis, specific arrangements to improve the autonomy of the relocated trading venues and of their board. However, as explained above, the PRC regrets that this case-by-case approach was not better framed through, for instance the establishment of a more developed set of conditions and organisational safeguards in light of the guidance provided in the TV Opinion. It appears that, in practice, the EU rules that the NCA has used a sole basis for their assessment were not always very specific leaving significant margin for interpretation. The PRC would question whether this approach provided for sufficient safeguards regarding the capacity of relocating trading venues to exercise effective decision-making powers and notes that, in practice, certain entities were authorised with only a limited number of staff and board members (some of them dual hatting)<sup>54</sup>.
212. Another NCA (NL) adopted a different approach which can be described as “group-in” rather than “firm-out”. As opposed to the two other NCAs, they deliberately accepted the inherent lack of independence that can exist in subsidiaries of international groups and tried to turn it into an advantage by facilitating involvement of group executives into the management of the relocated entities, thus making these individuals more involved into the problematics of the relocated trading venues and accountable to AFM. Although AFM made sure that decision-making powers and responsibilities formally remained at the level of the relocated entities for all activities conducted by the Dutch trading venues,

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<sup>52</sup> See in particular paragraphs 17, 18 and 19 of the Brexit Opinion on investment firms, paragraphs 35 and 38 of the General Brexit Opinion, paragraph 34 of the Brexit Opinion on trading venues.

<sup>53</sup> See in particular the ESMA Guidelines on the management body of market operators and data reporting services providers (ref. ESMA70-154-271) which set certain expectations regarding the composition of boards.

<sup>54</sup> The three Opinions emphasize that relocated entities need to have “effective decision-making powers”, including when they part of corporate group, see notably paragraph 18 of the Brexit Opinion on trading venues.

they did not consider necessary to set in place safeguards to limit in practice the influence of the group on the decisions taken by relocated trading venues. The NCA (NL) therefore did not require the participation of non-executive members or independent chair into the boards, or the existence of a supervisory function that is independent from the group<sup>55</sup>. That NCA also explained that, under Dutch law, they had no legal mandate to impose non-executive board members.

213. For the PRC, the above NCA (NL) approach could therefore be described as ensuring that decisions were taken at local level but with the active involvement of high-profile executives from the group. This raises the question about whether this approach is not based on an inherent contradiction and whether one can really consider that a decision is taken at local level when the responsibility for such decision lies within a board composed of a very limited number of members including high-profiles executive from the group. One of the sample documents provided described a board composed of three members including a high-profile executive from the group dedicating only 10% of his time to the relocated entity<sup>56</sup>. In addition, the concerned entity also operated an Approved Publication Arrangement and this small board was also responsible for this service.
214. The PRC would like to stress here that the ESMA Opinions emphasize that relocated entities need to have “effective decision-making powers”, including when they are part of corporate group<sup>57</sup>. This seems to indicate that NCAs’ authorisation procedures were expected to ensure that, beyond the formal decision-making powers, there would be some safeguards in place to limit the actual influence of the group on its EU subsidiary. The PRC notes that one NCA’s (NL) and the ESMA Opinions approaches in this respect do not appear to be fully aligned, the ESMA Opinion indicating rather a “firm-out” than a “firm-in” approach.
215. Similarly, as regards the possibility to dual hat for board members and senior executives, the PRC notes that, while all NCAs allow for such practice (with certain exceptions applied to certain functions), the level of scrutiny on this area differs among them, with one NCA (IE) setting clearer limits to this practice. In the case of the other NCAs (FR, NL), dual hatting was accepted for board members with, in both cases, some board members dedicating only a very small portion of their time to the relocated entity. The PRC remains sceptical about the really added value to have boards, which are already limited in size, with members dedicating only a fraction of their time to the relocated entity. In the case of one NCA (NL), they considered that this allows relocated entities to gain influence over the group (bottom-up influence) and for the NCA to have formal influence with this person and making him accountable in the EU. The PRC considers that this on the contrary creates, as explained above, conditions for a stricter control over the relocated trading venue from the group (top-down influence). Another NCA (FR) imposed clear restrictions on dual hatting for certain functions<sup>58</sup> relying notably on Article 91 of the Directive 2013/36/EU and section 5 of the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body. However, it was less clear how this practice was framed for other functions and for board members and, in this context, how they ensured a certain degree of independence for relocating trading

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<sup>55</sup> See paragraph 19 of the Brexit Opinion on investment firms.

<sup>56</sup> AFM clarified that, when authorised, a fourth senior manager was in training to become board member and already attended board meetings.

<sup>57</sup> See for instance paragraph 18 of the Brexit Opinion on trading venues.

<sup>58</sup> AMF required at least one of the effective managers to allocate 100% of his time to the French structure and did not allow compliance officers and professional card holders to dual hat with a foreign entity (UK or other country).

venues. The PRC regrets that this NCA (FR) did not have in place clearer rules in this respect.

216. In relation to reporting lines, the PRC acknowledges that all three NCAs allowed so-called dotted coordination lines to enable coherence at the level of the corporate groups. However, two NCAs (FR, NL) also did not allow direct/hierarchical reporting lines outside of the relocated entity. It was less clear to the PRC whether the third NCA (IE) set up similar specific measures and controls to limit functional reporting outside the local entity.

### **Assessment**

217. Accordingly, the peer review assessment of NCAs is as follows:

- a. FR: largely meeting expectations.
- b. IE: fully meeting expectations.
- c. NL: partially meeting expectations.

218. In terms of good practices, the PRC notes that:

- a. One NCA (FR) adopted a two-step approach regarding the fit and proper checks for certain positions, assessing CVs at authorisation stage and conducting licensing interviews for a subset of staff six months after the start of operation;
- b. Another NCA (IE) classified board members and heads of risk and compliance as Pre-Approved Control Functions (PCFs), a status that triggers more in-depth checks regarding possible existing conflicts of interest;
- c. One NCA (IE) set clear obligations applicable to all trading venues (no possible derogation) regarding board members including requiring an INED as chair of the board;
- d. One NCA (IE) did not allow dual hatting for certain functions (typically for executive directors and compliance and risk officers).

#### **4.2.1.2 Impact of outsourcing on decision-making powers and related risks**

219. The TV Opinion also specifically tackled the topic of outsourcing with a view to prevent increased risk for the EU. NCAs are notably required to take into account outsourcing arrangements with long or complex operational chains and/or with a large number of parties involved which may result in additional risks for trading venues and therefore supervisory challenges for NCAs. On this point, the TV Opinion also clarified that ESMA expects NCAs to assess outsourcing arrangements with third-country service providers in order to ensure that there are no potential detrimental effects to investor protection, orderly markets or financial stability. In particular, NCAs should assess information on the expected benefits and costs, including risks, of the envisaged outsourcing arrangement, and in particular the extent to which the trading venue has the capacity and means to control the service provider's actions and decisions in relation to outsourced activities.

### **Summary of findings**

220. Regarding the criteria and information assessed by the NCAs to conclude that the outsourcing of activities did not impair the ability of the relocated trading venue to comply with its obligation in relation to risks control and monitoring, all three NCAs (FR, IE, NL) mentioned the Service Level Agreements (SLAs) with the service providers, which applicants were required to submit. The three NCAs ensured that all types of outsourcing (i.e. outsourcing to intra-group entities or to external service providers) were covered by SLAs and that these agreements included certain provisions. All NCAs confirmed in particular that all SLAs they reviewed provided the relocated trading venues and EU NCAs with an access to the service provider if necessary.
221. It is important to note that in the vast majority of cases, relocated trading venues outsourced activities to intra-group entities. The risks associated with such a practice were considered a little differently by the three NCAs.
222. One NCA (NL) regarded outsourcing to entities of the same group as being fundamentally different from outsourcing to third parties, considering that it was not appropriate to expect the same level of formality for those aspects that are typical for third party outsourcing (for instance in relation to due diligence and back up plans, see below) or that the risk this creates for the entity benefitting from the outsourced services is of a different nature. That NCA explained that, if the solvency of a service provider is a crucial element to consider when a firm considers outsourcing part of activity to a third party, this assessment appears less relevant when the outsourcing entity is in the same group as the service provider. Similarly, the fact that (intra-group) outsourcing was often conducted from the UK was regarded as a risk mitigation factor; the UK and the EU still having legal frameworks which have a lot in common. The NCA however insisted that all other elements of outsourcing management were assessed with extra attention (documents to be submitted, monitoring, local recovery sites for offices, etc...) and the work programme incorporates one tab dedicated to outsourcing allowing the NCA to check compliance with all the applicable requirements.
223. Another NCA (IE) decided on the contrary to make no fundamental difference between external and intra-group outsourcing arrangements putting all outsourcing arrangements on a par for their assessments (e.g. in terms of documents to be submitted, expected monitoring, etc...). They also imposed some practical measures to mitigate the operational risk created by outsourced activity, e.g. direct and non-intermediated control over the kill switch functionality, local disaster recovery sites, etc.
224. The third NCA (FR) also took into account the operational risks related to outsourced activities requiring notably relocating trading venues to provide some specific information (e.g. number of staff allocated within the service provider to outsourced activities, a description of the risks that outsourced activities entail, whether the monitoring arrangements within the local trading venue are adequate, etc...) allowing to better assess the specific risks related to outsourcing.

## **Analysis**

225. The PRC welcomes that all NCAs required the relocating trading venues to provide SLAs with third party services providers and including intra-group service providers. Although it was not always clear how deeply this assessment was conducted, all NCAs appear to have a least check on some fundamental elements and in particular that SLAs allowed for effective oversight and supervision of outsourced activities. It should also be stressed that all NCAs imposed entity specific SLAs rejecting group SLAs.

226. Although NCAs described rigorous controls during on-going supervision, they did not always demonstrate that the specific risks relating to outsourcing had been systematically taken into account at authorisation stage. If some measures were nevertheless imposed, the PRC understands that this was done more on a case-by-case basis.
227. In this general context, the review conducted by one NCA (FR) nevertheless appeared as the most comprehensive, including: (i) in-depth review of Service Level Agreements (SLAs) during the authorisation process, (ii) assessment of the number of staff allocated within the service provider to outsourced activities, (iii) review of the monitoring arrangements within the local trading venue are adequate (staff involved, reporting lines, content of outsourcing reports, Key Performance Indicators (KPIs) used, etc...). The PRC considers in particular the review of the staff dedicated, within the group, to the performance of outsourced activities as a good practice allowing to anticipate already at authorisation stage on the quality of the service to be provided. The PRC nevertheless wonders whether the controls and checks were sufficient to ensure that “the trading venue [had] the capacity and means to control the service provider’s actions and decisions in relation to outsource activities” in particular regarding intra-group outsourcing and in light of the concerns raised above regarding the overall independence of the boards.
228. In the case of another NCA (IE), the PRC also noted some good practices such as the measures imposed to mitigate operational risk (e.g. non-intermediated kill switches, local disaster recovery site). It was however less clear to the PRC whether these measures were imposed to all relating entities.
229. Although another NCA (NL) assessed outsourcing arrangements of relocating trading venues, it appears to the PRC that this assessment has led to the general conclusion that these arrangements presented more limited risks (due to both being intra-group outsourcing and in relation to service providers in the UK). However, the PRC understands that despite considering that the risk of intra-group outsourcing is inherently limited (also because performed from the UK), the NCA has taken this into account when reviewing the general “risk controls and monitoring” arrangements of relocating trading venues (see below). The PRC also notes that that NCA’s work programme had a tab dedicated to requirements relating to outsourcing which demonstrates that detailed checks were performed regarding the outsourcing arrangements already at authorisation stage.

## **Assessment**

230. Accordingly, the peer review assessment of NCAs is as follows:
- a. FR: largely meeting expectations.
  - b. IE: largely meeting expectations.
  - c. NL: largely meeting expectations.
231. In terms of good practices, the PRC notes that:
- a. One NCA (IE) requested entity specific Service Level Agreements and imposed specific measures to mitigate operational risk such as non-intermediated kill switches, local disaster recovery site;

- b. One NCA (FR) reviewed the number of staff dedicated, within the group, to the performance of outsourced activities.

#### 4.2.1.3 Cost and Benefit Analysis and due diligence applied to service providers

232. NCAs should require that the trading venues' policies and procedures ensure they select service providers based on an adequate decision-making process and that trading venues continuously comply with their obligations under Union law. In particular, the TV Opinion puts emphasis on the fact that NCAs should be satisfied that trading venues have and maintain effective due diligence processes and that such due diligence should contain, inter alia, an analysis of all the benefits and cost including potential conflicts of interests. NCAs are also expected to examine any existing, as well as any planned, outsourcing arrangements and should ensure that trading venues establish and implement effective policies and procedures to monitor the performance of the outsourced activities and their compliance with the MiFID framework on an ongoing basis. NCAs should require trading venues to establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup facilities, where that is necessary having regard to the outsourced activity.

#### Summary of findings

233. One NCA (IE) requested trading venues to provide a specific analysis on the rationale for outsourcing. The NCA confirmed that they made no difference between external and intra-group outsourcing arrangements asking in both cases for the rationale for the decision to outsource and ensuring that outsourced activities are subject to local control and oversight. However, it was not clear how deep and on the basis of which criteria the NCA performed its assessment. The PRC understands that this request did not consist in a fully-fledged cost and benefit analysis (CBA). The controls and checks therefore appeared rather limited in practice.
234. Another NCA (FR) did not ask for a formal CBA to be provided for outsourced services (regardless whether outsourcing was within the group or with external service providers) and it was the NCA who conducted this assessment in practice, rather than the trading venue itself, making sure that trading venues (i) had sufficient resources and arrangements to ensure they were adequately equipped to manage the risks they were exposed to and (ii) had implemented appropriate arrangements and systems to identify all significant risks for operations and put in place effective measures to mitigate those risks. The NCA (FR) nevertheless required relocating trading venues to provide the rationale of the outsourcing arrangement and a description of the costs and charges agreed for the outsourced activities as well as a description of the risks those could represent for the relocated trading venue.
235. Another NCA (NL) explained that they had not considered appropriate to require relocating entities to conduct any CBA or due diligence regarding activities outsourced to entities within the same group. In that NCA's view, the decision to relocate certain functions to the EU or to continue performing them centrally (from the UK mainly) is a business decision. For that reason, they considered that obligations in terms of CBA or due diligence could not be applied to intra-group outsourcing.
236. All the three NCAs (FR, IE, NL) reported that they specifically checked that the trading venue retained control and oversight on the outsourcing functions. In this regard, the

NCAs also stated that they required the trading venues to appoint a specific person in charge of the outsourcing oversight, and in particular:

1. for one NCA (NL): a local Dutch board member with relevant skills and responsibilities.
2. For another NCA (FR): at least two executive managers, based in France and committing sufficient time to this, one responsible for controlling outsourced services and one responsible for internal control;
3. for the third NCA (IE): an Executive Director such as a Chief Operations Officer, to be nominated as Head of outsourcing oversight, responsible to monitor the performance of outsourced activity (KPIs and KRIs), maintain an outsourcing register and send regular reports to the board (at least on a yearly basis).

237. The three NCAs (FR, IE, NL) set clear supervisory expectations regarding the monitoring of outsourced activities (including to intra-group entities). One of them (FR) required all relocated trading venues to carefully monitor outsourced activities (general performance through adequate KPIs but also conflicts of interests, outsourcing contracts, etc...). Their monitoring plans (or control plans) were reviewed during the authorisation procedure and also during the NCA's on-going supervision. Another NCA (NL) ensured that this aspect was covered by the checked SLAs and outsourcing agreements and performance reporting and audits are controlled during on-going supervision.

### **Analysis**

238. The PRC regrets that none of the NCAs under review requested CBA or imposed due diligence process with respect to intra-group outsourcing as explicitly required under the TV Opinion.

239. The PRC understands that NCAs have considered that such procedures were not relevant for intragroup outsourcing since the benefits due to the nature of the outsourcing arrangements naturally exceed by far the potential costs and risks – in particular when these benefits and costs are considered from a group level perspective. The PRC notes however that the ESMA Opinions do not distinguish between outsourcing to an intragroup entity or to an external service provider. On the contrary those clarify, on multiple occasions, that reference to outsourcing includes intra-group outsourcing. The decision from the NCAs under review not to request these procedures with respect to outsourcing arrangements with entities of the same group is therefore not in line with the supervisory expectations stipulated in the ESMA Opinions.

240. In addition, the PRC agrees that outsourcing to an intragroup entity and outsourcing to an external service provider are of different nature. It is therefore accepted that the CBA or due diligence should reflect this difference. The PRC would however not conclude that those are useless exercises when it comes to intra-group outsourcing and regrets that such exercises were not systematically requested. CBAs can for example allow relocating trading venues and NCAs to better assess if the cost charged for the outsourced activities remains reasonable. Similarly, this can allow to identify risks that are specific to intra-group outsourcing, e.g. integrated IT systems with possible chained disruption, risk that EU entities' request are not treated with the same level of priority,

less autonomy of the performance of the outsourced services, risk to have unsatisfying communication channels, etc....).

241. Finally, if, as explained above, none of the three NCAs have undertaken formal CBA or due diligence, the PRC notes important differences in the approaches adopted. Two NCAs (FR, IE) tried to replace formal CBAs with alternative checks: (i) one NCA (IE), with an obligation for trading venues to provide specific considerations around the rationale for the outsourcing, and, (ii) for the other NCA (FR), with a review of the costs and charges for outsourced services. The PRC considers particularly useful to have ensured that the price paid for services outsourced to entities within the same group remain fair and is not used to illegitimately transfer profits outside the EU. This is regarded as a good practice.
242. As far as the monitoring of outsourced activities is concerned, the PRC welcomes the fact that two NCAs (FR, IE) made no distinction between outsourcing to an intragroup entity or to an external service provider. They both imposed a series of obligations which appear appropriate to the PRC. The other NCA (NL) also confirmed that they imposed reporting and audits to be performed by the relocated trading venues regarding outsourced activities.
243. The PRC also welcomes the fact that all NCAs required relocating trading venues to have one specific person in charge of outsourcing oversight. However, for two NCAs (FR, NL), the relocating trading venues' capacity and means to control and challenge the service providers in relation to outsourced activities, specifically when it comes to intragroup outsourcing, should be put in perspective of the reservations indicated above about the lack of clear safeguards to limit the influence on relocated entities of the group they belong to.

### **Assessment**

244. Accordingly, the peer review assessment of NCAs is as follows:
  - a. FR: partially meeting expectations.
  - b. IE: partially meeting expectations.
  - c. NL: partially meeting expectations
245. In terms of good practices, the PRC notes that:
  - a. All NCAs appointed a specific person in charge of the outsourcing oversight;
  - b. One NCA (FR) also ensured that the price paid for services outsourced to entities within the same group remained fair and would not be used to transfer profits outside the EU.

#### **4.2.1.4 System resilience and internal controls**

246. According to the TV Opinion, NCAs should require trading venues, and the service providers to which the trading venues outsource activities, to establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup facilities, where that is necessary having regard to the outsourced activity. The outsourcing of certain activities to third-country service providers should not result in a situation where the scope and independence of the internal control function is impaired, for instance



where trading venues carry out less intense oversight or conduct less frequent on-site visits due to the geographical location of, or close links with, the service provider.

## Summary of findings

247. In addition to what is mentioned under the previous sections, all NCAs devoted specific attention to the existence of relevant risk controls and effective monitoring practices at the level of the local entity, including outsourcing.
248. All NCAs (FR, IE, NL) received confirmation that all relocating trading venues had a contingency plan with their service providers and periodic testing of back-up facilities. NCAs performed specific checks on this.
249. In particular, for one NCA (NL), the resilience of the IT systems of relocating trading venues and more specifically the compliance of the systems and business continuity arrangements with relevant obligations was assessed using the so-called AFM work programme, which is a spreadsheet listing all relevant requirements (EU and domestic requirements) as well as the guidance that the NCA assessment officers needed to follow during the authorisation process. The spreadsheet, which is used for all authorisations, has a tab dedicated to resilience and IT issues where the NCA has listed all the relevant requirements to be complied with.
250. Another NCA (FR) assessed the resilience of relocated trading venues (in particular with respect to their IT systems) mainly on the basis of documents provided by applicants. Reviewed documents typically included the IT continuity plan, the risk mapping and the control plans. Furthermore, that NCA paid attention to the arrangements in place to prevent disorderly trading and breaches of capacity limits as well as to the circuit breakers implemented by the relocating trading venues (in particular in the case of digitalised trading venues). This included reviews of the compliance control plan and the risks mapping during the authorisation process to assess whether system resilience and associated risks were adequately mitigated and monitored.
251. Similarly, the other NCA (IE) assessed the resilience of relocated trading venues (in particular with respect to their IT systems) based on documents provided by applicants. These documents included (i) entity-specific risk appetite statements, Key Risk Indicators (KRIs), risk register and Internal Capital Adequacy Assessment Process (ICAAP). Relocated trading venues were also expected to monitor the performance of their systems through Key Performance Indicators. That NCA also asked applicants to submit a first RTS 7 self-assessment<sup>59</sup> during the authorisation phase.
252. This NCA (IE) required tailored-made documentation and firms were typically challenged when they provided generic Group's Business Continuity Plans (BCP) and Disaster Recovery plans (DRPs). As explained above, the NCA also imposed to have a local Disaster Recovery site and annual testing on the BCPs and DRPs. However, they explained that, in line with their risk-based approach, they generally ensured that all documents and procedures were in place but only reviewed their content when considered necessary.

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<sup>59</sup> Self-assessment of compliance with Article 48 of Directive 2014/65/EU which is required under Article 2 of the Commission Delegated Regulation (EU) 2017/584

253. When it comes to business continuity and disaster recovery planning, all NCAs (FR, IE, NL) required relocating firms to have in place policies and procedures on this area. It was however less clear to the PRC how deeply the three NCAs reviewed their content and substance at the authorisation stage. The PRC understands that for all NCAs, the detailed review of BCPs and DRPs was rather performed as part of on-going supervision and thematic reviews.
254. One NCA (IE) notably explained that it was difficult to conduct such a review at authorisation stage, i.e. when firms had not started their operations seeing limited value in testing the resilience of activities which had not yet been established. They however confirmed that this is an essential element and stressed that testing of system's resilience arrangements is part of the on-going supervision. However, it appears that this review is not conducted systematically during on-going supervision with the NCA relying on its impact assessment to identify entities where such review is deemed necessary (high impact firms). For the others, the NCA (IE) requires BCPs and DRPs to be tested by the trading venues at least once a year with any findings or action points reported to the board, but no scheduled review is carried out by the NCA directly as they generally relied on the firm to maintain and update this documentation to an acceptable standard.
255. The three NCAs (FR, IE, NL) also envisaged the involvement of IT expertise on this area. In particular, one NCA (NL) has adopted a six-eyes review approach for issues relating to systems' resilience involving the IT team, the authorisation assessment officers and the relevant supervisors. Another NCA (IE) reinforced the role of IT expertise within the authorisation team in certain cases only (e.g. when the relocating trading venue relied on Amazon Web Service or Trayport). The third NCA (FR) similarly appeared to have involved IT experts only on a very ad hoc basis.
256. With respect to the independence of the internal control function, all NCAs appeared to have devoted attention on this point.
257. For one NCA (IE), independence was ensured by prohibiting dual hatting for compliance and risk officers who were not allowed to work for more than one entity or to seat at the board. For another NCA (NL), the managers responsible for compliance and risk functions were not allowed to dual hat. Their function teams were authorised to cooperate intragroup but were required to operate in full independence hierarchically. It was ensured that these functions report to the local board alone. For the other NCA (FR), they did not allow dual hatting with a foreign entity (UK or other country) for compliance officers and professional card holders.

## **Analysis**

258. The PRC appreciates that all NCAs put a very good amount of emphasis on the controls and checks performed with respect to systems' resilience. In particular, the PRC considers that the systematic request of RTS 7 self-assessment by one NCA (IE) to all relocated entities is a good practice which contributes to increasing the self-awareness of concerned trading venues including in relation to their due diligence practices for outsourced services.
259. The PRC also welcomes the use of the work programme by another NCA (NL) to ensure that their review was comprehensive and well documented. Although more relevant to ongoing supervision, the PRC appreciates that that NCA (NL) required RTS 7 self-

assessment to be conducted on a yearly basis (instead of at least every five years in RTS 7) and performed two thematic reviews on these aspects.

260. Although all NCAs have requested relocating trading venues to have in place a comprehensive list of policies and procedures, the PRC regrets that the review of these documents was rather superficial at authorisation stage leaving to the on-going supervision to undertake a detailed review of those (this was typically the case with respect to BCPs and DRPs). With respect to one NCA (NL), the PRC however notes that this review of BCPs and DRPs was part of a specific thematic review just after authorisation of relocating entities.
261. The PRC also welcomes that NCAs have involved IT experts into the authorisation procedure. In particular, the six-eyes approach by one NCA (NL) to issues relating to systems' resilience is regarded as a good practice allowing for systematic involvement of IT experts. In the case of another NCA (FR and IE), IT experts appeared to have been only seldom involved during the authorisation process (they rather intervene during on-going supervision) and the PRC regrets that IT experts were not more systematically involved in the assessment of relocating trading venues. The PRC notes that NCAs have all insisted on the fact that IT activities are an essential part of the operation of trading venues which calls for appropriate expertise also at authorisation stage.
262. The PRC notes that NCAs devoted specific attention to the independence of the internal control. As stated before, the PRC regards as a good practice the intention to strictly frame dual-hatting practice, in particular in relation to key functions like compliance and risk, in order to ensure that those functions do not suffer the influence of other entities of the group and can devote sufficient time to their activities within the local firm.
263. The PRC welcomes that one NCA (NL) required relocating trading venues to have a dedicated compliance and risk function where at least the managers responsible for this function were not allowed to dual hat.

### **Assessment**

264. Accordingly, the peer review assessment of NCAs is as follows:
  - a. FR: fully meeting expectations.
  - b. IE: fully meeting expectations.
  - c. NL: fully meeting expectations.
265. In terms of good practices, the PRC notes that:
  - a. One NCA (NL) used a work programme listing all relevant requirements (EU and domestic requirements) as well as the guidance that the NCA's assessment officers needed to follow during the authorisation process; the spreadsheet had a tab dedicated to resilience and IT issues;
  - b. This NCA (NL) also adopted a six-eyes review approach for issues relating to systems' resilience involving the IT team, the authorisation assessment officers and the relevant supervisors;
  - c. Another NCA (IE) required to all applicants the submission of a first RTS 7 self-assessment during the authorisation phase and a questionnaire on IT risks.

## 4.2.2 Substance

### 4.2.2.1 Human and financial resources

266. In accordance with the TV Opinion, NCAs should pay particular attention to situations where trading venues would perform substantially more key and important activities from a third country by using outsourcing arrangements and in consequence maintain more relevant human and technical resources in that third country than in the EU. NCAs should therefore require that trading venues do not outsource activities to an extent that exceeds by a substantial margin the activities performed within the EU.

#### **Summary of findings**

267. All three NCAs acknowledged that relocated trading venues rely largely on activity performed at group level outside the EU. They confirmed that there were cases where the number of staff (or Full-Time Equivalents) working for the relocated entity was higher outside the EU than at local level. The main argument raised by NCAs was that operators of trading venues are today mainly providers of IT services (rather than, *stricto sensu*, operators of a trading platform). IT-related tasks are the most resources-consuming part of their activity and these tasks are generally performed at group level to ensure efficiency and mitigation of risk. It was therefore considered natural that most of relocating trading venues operate with only a limited number of staff in the EU with the support of larger team from the group.
268. Another argument put forward by all NCAs to explain the limited number of relocated staff related to the difficulty to require applicants to relocate very large teams when their activity had not started. All NCAs confirmed though that they supervise the increase in the local number of staff as the business grows to make sure that the number of staff employed directly by the relocated trading venues remains in line with the activity undertaken in the EU - no specific criteria or thresholds of relevance have however been established by any of the NCAs.
269. If the general finding above is applicable to the three NCAs, some important differences could nevertheless be observed between them.
270. As explained above, one NCA (IE) focused its attention on having adequate resources within the board (see section 4.2.1.1 above related board members and senior managers). They however dedicated less attention and efforts to having staff relocated to Ireland. Typically, for IT functions, they explained that requesting to relocate IT staff could potentially lead to an increase of operational risk. They also did not impose strict rules regarding the relocation of voice brokers (see the section 4.2.2.2 on outsourcing of key and important functions).
271. Another NCA (NL) appeared to have also dedicated limited attention to the specific number of staff being relocated and explained that they had instead focused their attention on having targeted functions in the Netherlands (e.g. compliance, risk client-oriented services) and making sure that these positions were filled with staff with an appropriate level of expertise. They considered that for certain activities (typically IT development and maintenance), a relocation was indeed unnecessary, unrealistic and not in the interests of the clients and investors (duplicated IT systems would have meant more costs and risks).

272. That NCA (NL) employed in practice a certain level of judgement and discretion as to the level of staff required to be employed by the local entity, deciding on a case-by-case basis and depending on the specificities of the concerned entity. Based on Dutch legal requirements, the NCA expected certain functions locally, but applied proportionality in what was expected in numbers. As mentioned above, uncertainties around Brexit and success of relocated activity incentivise firms to relocate staff progressively. The NCA explained that they took this into consideration with the expectation and sometimes explicit written condition that the number of EU based staff would grow with their business. The NCA also explained that this is part of their on-going supervision to make sure that the number of staff employed directly by the relocated trading venues remains in line with the activity in the Netherlands. They added in this respect that some relocated trading venues have grown bigger in terms of staff than what had been agreed with AFM at the time of authorisation.
273. Another NCA (FR) also authorised some relocated trading venues with minimal number of staff (one trading venue was authorised with only 4 local staff). The NCA insisted on the fact that this was the case when the group of the trading venue as a whole had limited staff. They also stressed that in these cases some staff of other entities of the group were dedicated to the operations of the French entity (7 FTEs for the aforementioned group) making the overall staffing more substantial. They also insisted on the fact that they paid particular attention to the authorisation of these smallest trading venues ensuring that appropriate safeguards were in place, e.g. detailed outsourcing contract and SLAs, regular controls and monitor at local level of the services provided outside the EU, etc. Lastly, the NCA stressed that, in the example mentioned above, the proposed set up had been approved at a stage where the French entity lacked visibility on the future development of its activity in the EU.
274. However, that NCA (FR) took a stricter approach with respect to relocated trading venues where transactions are matched through voice brokers – which is the case for most relocated trading venues in France according to the NCA. For those, the NCA imposed that brokers executing transactions on behalf of on EU clients are located in France (see below) - as opposed to another NCA (IE). In practice though, a none negligible part of the brokers relocated to the EU benefitted from secondment arrangements (secondments contracts from six months to five years).
275. NCAs (IE in particular) stressed that it was not always easy to quantify with exact certainty the amount of work performed at group level (line was not always easy to draw). The exact proportion of time allocated by staff located outside the EU is not always easy to determine (both because it is not carefully monitored and because some tasks are performed for the entire group). Another NCA (NL) explained that they did not consider necessary to measure the scale of outsourcing to the group (as compared to what is performed from the Netherlands) preferring to focus on the substance of the activity performed in the Netherlands.
276. Regarding the domiciliation of staff, two NCAs (IE, NL) have allowed FIFO arrangements (Fly In and Fly Out, i.e. people coming to Ireland or the Netherlands just for work but that still have their main domicile in a third country). It is not clear whether the other NCA (FR) has taken the same approach. That NCA (FR) indeed explained that Brexit occurred during the pandemic crisis where no FIFO was anyhow possible in France without further explaining their position regarding such working arrangements.

277. NCAs also did not perform in-depth checks on the contractual arrangements used for staff. In fact, it seemed that, while some relocating trading venues hired staff directly, other groups adopted a different approach whereby all staff were contractually linked to the group and were seconded to the EU entity. In some cases, local staff was shared between the business of the trading venue and the Approved Publication Arrangement (APA) operated by the same relocated operator. One NCA (NL) explained in particular that, according to their assessment, the specific characteristics of these contractual arrangements did not impair compliance. They were allowed (see below), and the NCA focused instead their assessment on reporting lines and responsibilities. In the case of another NCA (FR), they explained that such contractual arrangements (staff contractually linked to the group and seconded to the relocated entity) would be considered outsourcing in France. However, they did not seem to have conducted in-depth checks in this respect since interaction with market stakeholders revealed that, in practice, secondments contracts were used to relocate some brokers to the EU (without these brokers being considered as outsourced activity).

## Analysis

278. The PRC notes that, in all assessed jurisdictions, there were cases where relocated trading venues were authorised with more staff working (directly or indirectly) from outside the EU than from within the concerned EU jurisdiction. The PRC even understands that this was the case for almost all relocated trading venues authorised. This is mainly a consequence of the heavy reliance on services or functions (typically IT and support functions) performed by other entities belonging to the same group.

279. On this point, the PRC acknowledges the arguments raised by NCAs around (i) the overall uncertainties around Brexit and about the success of relocated activities and (ii) the nature of activities undertaken by trading venues (strong IT dimension).

280. The PRC nevertheless considers that this was a crucial element of the TV Opinion and that it should have been given more attention. Indeed, the TV Opinion states that NCAs should require that trading venues do not outsource activities to an extent that exceeds by a substantial margin the activities performed within the EU, maintaining more relevant human and technical resources in that third country than in the EU.

281. Furthermore, the PRC would like to stress that this general pattern appears to be more pronounced in one country (NL), the NCA arguing that it wished to remain outcome-focused and pragmatic. The PRC strongly supports an outcome-focused approach to supervision. Nonetheless, the PRC believes that, with respect to staffing arrangements, this NCAs' approach is not in line with the guidance provided in the TV Opinion.

282. During the on-site visits, the PRC also noted that NCAs were not always capable to quantify with accuracy the magnitude of outsourcing for relocated trading venues. The PRC would therefore invite the concerned NCAs to better monitor this aspect both in terms of (i) staff (in Full Time Equivalent) working for the relocated trading venues from outside the EU and (ii) part of revenue that is eventually paid back to the group for outsourced services. The PRC understands in this respect that one NCA (FR) is already monitoring the cost of outsourced services for relocated trading venues which is considered a good practice.

283. The PRC also disagrees with one NCA (NL) regarding the importance of the contractual arrangements for staff employed by relocated trading venues. The PRC considers

relevant that some staff have a direct contractual relation with the group (or other entities from the group) and regrets that this issue was not more thoroughly assessed by all NCAs, for instance in terms of influence that the group can exercise on the relocated trading venues through these arrangements. With respect to another NCA (FR), the PRC regrets the use secondment contracts for the relocation of staff and brokers in particular. Such contractual arrangements raise questions not only regarding the limited duration of these staff relocations but also regarding the conflicts of interests this could create with the group.

## **Assessment**

284. Accordingly, the peer review assessment of NCAs is as follows:

- a. FR: not meeting expectations.
- b. IE: not meeting expectations.
- c. NL: not meeting expectations.

### 4.2.2.2 Outsourcing of key and important functions

285. The TV Opinion explicitly puts a limit to the possibility for a trading venue to outsource certain specific functions, which are considered to be at the core of the trading venue operation and supervision and therefore should be kept at the level of the local entity. In particular, the TV Opinion sets out that, in order to ensure that NCAs can effectively supervise the trading venue, and take supervisory action in case of an emergency, the decision-making for designing, controlling and monitoring the operation of the trading system should not be outsourced outside the EU. Therefore, NCAs should not allow the outsourcing of admission to trading of financial instruments, establishment and any subsequent changes to the rulebook of the trading venue, suspension and removal of financial instruments from trading and mechanisms to halt trading outside the EU.

## **Summary of findings**

286. All NCAs (FR, IE, NL) confirmed that, for all relocated entities, the decision-making for designing, controlling and monitoring the operation of the trading system, as well as the activities of admission to trading of financial instruments, establishment and any subsequent changes to the rulebook of the trading venue, suspension and removal of financial instruments from trading and mechanisms to halt trading was not outsourced outside the EU.
287. However, all NCAs also leveraged on the argument that trading venues are currently mainly IT driven and therefore, particularly as regards subsidiaries of an international group, usually platform maintenance and development is performed at group level. In this regard, they stressed that, while they ensured that decision-making is kept at the level of the local entity, the technical arrangements and practical implementation of decisions relating to the key functions set out above are usually subject to outsourcing (e.g. with respect to suspension from trading).
288. There were however some noticeable differences between NCAs regarding the exact scope of activities they authorised to be outsourced. This concerned for instance the approach adopted regarding Inter-Dealer Brokers (IDB). One NCA (FR), which generally required front-office and client facing activities to be relocated to France, required that

brokers executing transactions on behalf of on EU clients were located in France. This therefore led the NCA to oblige relocating IDBs to have a number of Paris-based brokers which is in line with the level of activity conducted in the EU. As noted above, these relocations were, at least part of them, implemented through secondment contracts, the brokers maintaining their contractual arrangement with the UK entity and being seconded to the EU entity. This approach was nevertheless much stricter than the one adopted by another NCA (IE) who allowed voice brokers to stay in the UK while dedicating a portion of their time to the EU entity. Another NCA (NL) didn't authorise any trading venue operating voice trading systems and was therefore not concerned by this issue.

289. Regarding one NCA (NL), the practical arrangements regarding outsourcing of key functions were assessed on a case-by-case basis. One example mentioned was the different approved arrangements for market surveillance. While that NCA considered market surveillance as a critical function, they adapted their requirements depending on the activities of the relocated trading venues. For all relocated entities, the responsibility for market surveillance remained in the Netherlands but in practice there were significant differences between trading venues regarding the number of staff allocated to this and the amount of operational (not decision-making) activities carried out by the Dutch entity.
290. Similarly, different approaches were noted regarding policies and rulebooks. After an internal legal analysis, one NCA (NL) accepted rulebooks that were the same as the rulebooks used by the same group in the UK. It was notably confirmed that the rulebooks in some cases refer to the UK law with UK jurisdictions being competent in case of legal disputes. In addition, although there is, in the Netherlands, a formal process of approval of the rulebook for Regulated Markets, for MTFs and OTFs, rulebooks are simply notified to the NCA (rulebooks are reviewed but not formally approved). The NCA accepted shared policies when they could apply globally (and particularly in the EU) and when the Dutch entity was included explicitly. The NCA insisted on the fact that relocated entities were often from full-fledged firms, operating in a comparable legislative framework and with very matured and well calibrated procedures. In this context, imposing a complete overhaul would have created unnecessary burden.
291. On the contrary, another NCA (IE) requested bespoke rulebooks for Irish entities and imposed to be notified three months in advance of any change to the accepted rulebook. Although rulebooks are not authorised as such, they are subject to non-objection by the NCA. The NCA also asked relocated entities to have specific policies and procedures in place (no carbon copies of the group policies and procedures) even though it did not systematically review the firm's policies and procedures to ensure that this approach was applied in all cases.
292. Finally, another NCA (FR) explained that they dedicated significant attention to having policies and procedures that are specific to the French entity. Typically, they had intense discussions regarding the rulebooks of the relocating trading venues requesting bespoke rulebooks and imposing where necessary adjustments to these rulebooks (which are approved by the NCA board) to match their own supervisory practices. Some parts were therefore reinforced, and they specifically requested the rulebooks to be governed by French law with French jurisdictions being competent in case of legal disputes. The NCA insisted on the fact that all modifications to the initial rulebook are also subject to a prior approval by the NCA board.

## Analysis



293. The PRC understands that although all NCAs have allowed relocated trading venues to outsource a significant part of their activities to other entities within the group, they insisted on the fact the decision-making powers and responsibilities attached to outsourced services to always lie with the relocated entities. The PRC considers that if the TV Opinion prohibits the outsourcing of key and important activities (e.g. operation of the trading system, suspension, trading halts), it recognises the possibility to outsource at least the technical arrangements outside the EU. The PRC however notes that the TV Opinion does not seem to have anticipated that this possibility would be used almost systematically<sup>60</sup> putting on the contrary significant emphasis on the importance to ensure that the activity of relocating trading venues would maintain some substance and not be letter box entities.
294. Although, the NCAs' practices could appear to be at first sight in line with this guidance, the PRC considers that the magnitude of intra-group outsourcing raises some questions and should have been analysed more thoroughly by NCAs. The PRC regrets that NCAs did not dedicate more efforts on convincing relocating entities to have more activities (including technical activities) being relocated. NCAs instead accepted as inevitable outcome that technical arrangements would almost entirely be performed outside the EU focusing their efforts only on maintaining decision-making in the EU.
295. In addition, the PRC considers that the approach taken regarding outsourcing (i.e. not strict limitations as long as relocated trading venues maintain full control and responsibilities for these activities) should be analysed in the light of findings on whether NCAs established sufficient safeguards to ensure effective decision-making power at the level of the relocated entity (see section 4.2.1.1 on the independence of board members and senior managers). The PRC is concerned about the absence, in certain cases, of effective and concrete safeguards to ensure effective autonomy of the relocated entities somewhat put into question the ability of relocated trading venues to exercise autonomous decision-making powers also on these outsourced functions. In particular for key functions, the large-scale reliance on the group to perform technical arrangements should at least have been accompanied by strong organisational arrangements to ensure that responsibility is effectively at EU level.
296. For one NCA (NL) in particular, the PRC notes that as mentioned above, the NCA specifically requested high-profile executive from the group to be appointed in the boards of relocated trading venues with a view to make them more acquainted with issues of the EU entity and accountable vis-à-vis the NCA. However, by doing this, the NCA also deliberately accepted the influence of the group on the board, which puts into question the effectiveness of the decision-making powers of the EU entity regarding the operational control and oversight of outsourced activities.
297. In addition, the PRC notes that the operation of a trading system is considered as a key activity of trading venues and cannot therefore be outsourced<sup>61</sup>. If there are valid arguments not to require trading venues to operate a duplicated trading system in the EU for digitalised platforms, the question is less obvious with regard to voice brokerage platforms. The PRC welcomes the approach taken by one NCA (FR) in this regard, requiring that the number of brokers located in France remained aligned with the level of activity conducted in the EU, even if, as indicated in the section above, the specific

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<sup>60</sup> For instance, in paragraph 30 the opinion on trading venue mentions the possibility to outsource technical arrangements but only with respect to admission and suspension of financial instrument from trading and trading halts.

<sup>61</sup> See paragraphs 28 and 29 of the Brexit Opinion on trading venues.

contractual arrangements used (secondment contracts in certain cases) raise questions. The PRC regrets that a similar approach was not adopted by another NCA (IE) and that that NCA did not better reflected the crucial importance of having brokers in the EU in the staffing arrangements they approved.

298. The PRC would like to stress that rulebooks are a key document for trading venues describing the rules governing their operations and, hence, their compliance with EU rule. It is therefore crucial that these documents are as detailed as possible and carefully monitored by supervisory authorities.
299. The PRC notes that, among the NCAs under review, one NCA (FR) dedicated greater attention to the rulebooks of the relocating entities during the authorisation process, ensuring that they were tailored-made, reinforcing certain aspects to align them with their supervisory practices and approving them at NCA board level. The PRC welcomes this approach which recognises the pivotal role this document plays in the operation of a trading venue.
300. Although, another NCA (IE) did not go as far regarding the attention devoted to the rulebooks, the PRC appreciates that they at least required specific rulebooks to be submitted (the NCA however did not elaborate on whether they imposed rulebooks that were really tailored-made).
301. The PRC notes that, on the contrary, the other NCA (NL) allowed rulebooks which were largely similar of the one used in the UK. If this does not raise immediate concerns regarding their compliance with EU (the NCA confirmed that the approved rulebooks were fully in line with EU laws), the PRC wonders whether this approach allowed to take the specificities of the Dutch entities and EU markets into account.
302. The PRC reaches similar conclusions with the respect to other policies and procedures where two NCAs (FR, IE) appeared to have pay more attention to having tailored-made policies while one NCA (NL) seemed more comfortable with accepting shared policies. The PRC considers that more dedicated policies not only reinforce the materiality of the relocated trading venue but, more generally, provide more flexibility to these relocated trading venues regarding their ability to adapt their procedures to the specificities of EU markets.

## **Assessment**

303. Accordingly, the peer review assessment of NCAs is as follows:
  - a. FR: largely meeting expectations.
  - b. IE: largely meeting expectations.
  - c. NL: largely meeting expectations.
304. In terms of good practices, the PRC notes that:
  - a. One NCA (FR) required to have voice brokers located in the jurisdiction;
  - b. Two NCAs (FR, IE) asked relocated trading venues to have tailored policies, procedures and rulebooks.



#### 4.2.2.3 Effective supervision of outsourcing arrangements with third-country service providers

305. The TV Opinion states that NCAs should have the capacity and adequate resources to effectively supervise trading venues and ensure compliance with Union law, including for outsourced activities. NCAs should require the cooperation of the third country service provider in connection with the outsourced activity. NCAs should only accept outsourcing arrangements where the trading venue outsourcing the activity, its auditors and its NCA have effective access to any relevant information including books and records of the third country service providers concerning the outsourced activity, as well as effective access to the relevant business premises of the service provider for on-site visits for the performance of their respective responsibilities.

#### Summary of findings

306. All NCAs under review have set in place a cooperation agreement with UK authorities (the UK FCA in particular), in order to supervise effectively the trading venues established in their member state, including when outsourcing to the UK is in place. In most cases, they relied for this on the ESMA Memorandum of Understanding (MoU). AFM also signed a partnership agreement in June 2019 with the UK FCA<sup>62</sup>. It is not clear whether, in addition to this MoU, two NCAs (FR, IE) also established bilateral cooperation agreements with the UK authorities.

307. As regards the access to information and premises of third service providers, all NCAs confirmed that they had the necessary powers to collect necessary information where needed. This was ensured through specific clauses within the SLAs between those parties and the trading venues supervised. All NCAs confirmed that in practice they would channel their requests to the third country providers through their supervised entities.

308. Furthermore, while all NCAs explained that they liaised with the FCA during the authorisation process of relocating entities, these interactions were apparently more focused on exchanging and gathering information about the entity itself in order to explore their “history” rather than checking whether there is any impediment to access information from third country services providers.

#### Analysis

309. Regarding the supervision of outsourcing arrangements, the PRC notes that the possibility to access to information has been part of specific provisions in SLAs required by all NCAs to be included in the documentation submitted by applicant trading venues in the authorisation process.

310. Two NCAs (FR, NL) undertook detailed reviews of the content of these SLAs already at authorisation stage. Regarding another NCA (IE), the PRC understands that they did not conduct detailed reviews of these SLAs but at least ensured that they covered certain aspects such as the full and unrestricted access to the service providers (including intra-group service providers) by both the relocated trading venues and the NCA.

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<sup>62</sup> [FCA and AFM agree on closer partnership | June | AFM](#)



311. The PRC also appreciates that all NCAs have in place an MoU with the UK FCA, with a view to ensure, among others, that they can also liaise with the UK authority in case they need specific cooperation on supervisory matters.

### **Assessment**

312. Accordingly, the peer review assessment of NCAs is as follows:

- a. FR: fully meeting expectations.
- b. IE: fully meeting expectations.
- c. NL: fully meeting expectations.

## **4.3 Peer review findings: Fund Managers**

### **4.3.1 Governance**

#### **4.3.1.1 Independent and effective decision-making**

313. The IM Opinion requires NCAs to be satisfied that relocating entities have established sound governance and internal control mechanisms for an independent and effective decision-making.<sup>63</sup>

314. In this context, the PRC investigated whether NCAs assessed if applicant firms established sound governance and internal control mechanisms through: (i) a clear allocation of all key management responsibilities, (ii) an absence of structures that could hinder a clear allocation and execution of these responsibilities, (iii) documented policies and procedures and (iv) regular reporting to senior management and the board of directors.

##### **4.3.1.1.1 A clear allocation of management responsibilities**

315. Paragraph 18 of the IM Opinion states that NCAs should expect and receive evidence that the key responsibilities listed in relevant EU legislation have been clearly allocated to members of the governing/management body, the senior management and, where it exists, the supervisory function of authorised entities.<sup>64</sup>

316. In this context, relevant evidence includes details on, inter alia, (individual) assigned responsibilities, resources, reporting lines, management information and decision-making processes.

### **Summary of findings**

317. All NCAs (FR, IE, LU, NL) required a central document, such as a programme of activities/operations, describing various processes of the applicant firm, including certain decision-making processes.

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<sup>63</sup> In particular, paragraph 18 of the ESMA Opinion.

<sup>64</sup> In particular, Article 9 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive) and Article 60 of the Commission Delegated Regulation (EU) No 231/2013 (AIFMD Level 2 Regulation).

318. In this context, all NCAs (FR, IE, LU, NL) requested and received organisational charts in which (internal) reporting lines are visually presented and had supervisory practices in place to review the allocation of responsibilities of senior managers of applicant firms.
319. In addition, two NCAs (LU, NL) used checklists or other supervisory tools to provide for a comprehensive and practical overview of how the relevant responsibilities were allocated, whereas no such tools were used by the two other NCAs (FR, IE).
320. While one NCA (NL) assessed the governance arrangements during the authorisation process, some of the responsibilities in a sample case relating to a large fund manager were not clearly allocated at the end of the process, when the authorisation was granted, or this were not adequately recorded in the authorisation file.
321. Another NCA (FR) permitted to establish a governance structure in which the two senior managers of a small applicant firm were jointly responsible for several/all key functions. The allocation of individual responsibilities was neither sufficiently clarified in the authorisation file nor challenged by the NCA.
322. One NCA (IE) permitted, albeit temporarily, an overall configuration in which the applicant firm made use of seconded staff that assumed senior management responsibilities, including those listed in the EU legislation.<sup>65</sup>
323. This NCA (IE) also granted authorisation to another applicant firm that was expected to manage a very broad range of (complex) strategies (long/short, mid and small caps, technology companies in the US, ESG, Infrastructure, Global Equity, Total Return, Alternative credit including structured credit products, commercial and residential backed mortgages etc). From the documentation provided, it was not clear how the responsible senior manager was equipped to fulfil the control and oversight responsibilities of the portfolio management function.
324. Another NCA (LU) used a compliance table on organisational requirements that provided for an itemised overview of how the responsibilities listed in EU legislation were implemented. Next to the details contained in the policies and procedures that were reviewed by this NCA, this table provided for a comprehensive and practical overview of how the relevant responsibilities were allocated. However, no such table was used in one of the sample cases. An explicit and comprehensive overview of all responsibilities listed in EU legislation was therefore missing in the authorisation file.

## Analysis

325. Having assessed a number of sample cases, the PRC notes that there was a high variety in the level of detail requested and collected by NCAs on the allocation of responsibilities and decision-making process of applicant firms. For some responsibilities the documentation merely provided the name of the responsible senior manager, without further specifying the relevant details on how the allocated responsibilities could be fulfilled. In the context of Brexit these details may have been additionally relevant as applicant firms often made use of (human and technical) resources of UK entities, as well as group decision-making structures.

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<sup>65</sup> In particular, Article 9 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive) and Article 60 of the Commission Delegated Regulation (EU) No 231/2013 (AIFMD Level 2 Regulation).

326. Although all NCAs (FR, IE, LU, NL) had supervisory practices in place to review the allocation of responsibilities of senior managers of applicant firms, in general, not all NCAs (FR, IE) had sufficiently formalised supervisory practices and tools in place to review a clear allocation of all the responsibilities listed in the aforementioned legal provisions. The PRC found that the information provided by applicant firms in the sample cases relating to those NCAs (FR, IE) did not explicitly and fully address all the responsibilities listed in EU legislation.
327. The PRC therefore regrets that these two NCAs (FR, IE) did not introduce a more comprehensive and systematic approach to identifying and analysing compliance with the legal requirements set out in the EU legislation during the authorisation stage. The NCA assessments in this context should have been based on documentary evidence provided by applicant firms (e.g. in the form of detailed policies and procedures, terms of reference of internal or group bodies etc).
328. The governance setup permitted by one NCA (IE) in a sample case that related to a large fund manager raised concerns for the PRC as the seconded staff (i) assumed senior management responsibilities despite only allocating limited time to the applicant firm, (ii) was not based in the offices of the applicant firm, (iii) was still employed by a White Label service provider and (iv) did not have full/direct access to the systems of the applicant firm. As such, the PRC is of the view that the relevant responsibilities were not assigned to persons that could effectively fulfil those responsibilities. However, the NCA (IE) notes that the governance structure was subsequently amended and the secondees replaced with permanent resources. The initial setup also raised other concerns as described in the following sections, in particular in relation to the adequacy of human resources and potential circumvention of the delegation rules.
329. While the PRC positively notes that two NCAs (LU, NL) did use checklists or similar supervisory tools to provide for a comprehensive and practical overview of how the relevant responsibilities were allocated, these documents were not used in a consistent manner in the sample cases provided. The PRC therefore recommends to both NCAs to use these already available tools consistently in all cases.
330. The PRC views checklists or similar overview documents as a useful supervisory tool to verify and record in a complete and consistent manner that all the key management responsibilities referred to in the aforementioned legal provisions had been clearly allocated to the relevant persons.
331. The PRC therefore invites two NCAs (FR, IE) to consider using checklists or other supervisory tools covering all responsibilities set out in the relevant EU legislation to facilitate the supervisory assessments and ensure that the analysis is performed in a complete and consistent manner. The PRC also invites the other two NCAs that already have such tools to use them in a more consistent manner.

#### 4.3.1.1.2 Absence of structures that could hinder a clear allocation and execution of responsibilities

332. NCAs should have a supervisory approach to assessing governance structures that could hinder the clear allocation and execution of responsibilities, in particular the use of internal or (UK) group committees that may interfere with the clear allocation of responsibilities within the applicant firm.

333. The use of (UK) group committees may provide some general advantages as they can help to facilitate the transfer of available knowledge and expertise within the corporate group. However, such committees should not impair, or unduly influence, the clear allocation of responsibilities within authorised EU entities. Moreover, the use of such committees may also give rise to conflicts of interest and circumventions of the AIFMD and UCITS delegation requirements.
334. To determine whether the use of (UK) group committees could pose such risks, supervisory assessments concerning the roles, decision-making powers, membership and voting rights of committees and their members are required on the basis of evidence provided by applicant firms, for example through the review of the Terms of Reference of the envisaged or existing (UK) group committees and minutes of previous meetings, where available.

### **Summary of findings**

335. All NCAs (FR, IE, LU, NL) received general descriptions and information of the existence of (UK) group committees.
336. Three NCAs (FR, LU, NL) performed some general analysis regarding the composition, voting rights, role and agenda of (UK) group committees of relocating entities.
337. Some NCAs (FR, LU, NL) also had specific criteria in place related to the use of (UK) group committees.
338. In this context, one of the NCAs (FR) required that the majority of voting members of committees of applicant firms, which could include group members, are employed by the applicant firm to ensure independence of the local entity. This NCA conducted supervisory assessments on (UK) group committees on the basis general descriptions included in the application documentation, and detailed evidence such as the Terms of Reference. The NCA also highlighted that (i) it required that the majority of voting members of group committees were employed by the relocating entity to ensure independence of this entity, and (ii) it ensured that the decision-making power remained within the applicant firm. This NCA did not require detailed evidence of group committees where the parent undertaking of the UK-based entity was established in its own member state as it perceived the supervisory risks to be lower in such cases.
339. Another NCA (LU) required that the majority of members of group committees were employed by the applicant firm and decisions could only be taken in unanimity or when members of the local entity voted in favour. This NCA usually relied on details provided in the application documentation, without requiring detailed evidence, such as Terms of Reference. Furthermore, the level of detail of the descriptions on (UK) group committees provided by applicant firms varied across the sample cases.
340. One NCA (NL) performed a proactive, systematic and comprehensive supervisory assessment of the use of group committees and related conflicts of interest or circumvention risks based on documented evidence, in particular the Terms of Reference. This NCA also reviewed the minutes of previous minutes of the committees, where available.
341. One NCA (IE) did not require specific details or documented evidence regarding (UK) group committees other than generic descriptions at the time of authorisation.

### **Analysis**

342. The PRC observed that the level of consistency and formalisation of the supervisory assessment of (UK) group committees varied between NCAs.
343. While three NCAs (FR, LU, NL) generally performed analysis regarding the composition, voting rights, role and agenda of (UK) group committees of applicant firms, the documentary evidence requested and the depth of supervisory analysis thereof, was not consistent.
344. One NCA (FR) refrained from requiring detailed evidence of group committees when the UK parent undertaking of the applicant was ultimately itself member of a local banking group subject to consolidated prudential supervision by this NCA (FR). The NCA explained that it perceived the supervisory risks to be lower in such cases as the ultimate parent undertaking was established in its own member state and therefore subject to its supervision. However, the PRC is not convinced that solely the location of the ultimate parent would be a decisive factor to apply lower supervisory standards.
345. The PRC is also concerned that one NCA (IE) did not require specific details or documented evidence regarding (UK) group committees other than generic descriptions.
346. In light of the above, the PRC would see merit in some NCAs (FR, IE, LU) reviewing the use of internal and (UK) group committee structures more thoroughly and consistently during the authorisation stage to ensure that they do not result in any circumvention of applicable regulatory requirements, in particular the requirements on the clear allocation of responsibilities of senior managers/board of directors, conflicts of interest and delegation requirements.
347. In this context, the PRC would like to highlight in particular the need to ensure compliance with the applicable legal requirements on risk committees which explicitly require that where such committees are established, they shall be appropriately resourced and its non-independent members shall not have undue influence over the performance of the risk management function.<sup>66</sup>

#### 4.3.1.1.3 Documented policies and procedures

348. NCAs should ensure that the documented policies and procedures that are explicitly referred to in relevant EU legislation were put in place and provided for a clear allocation of responsibilities to the relevant persons and clear decision-making processes.<sup>67</sup>

### Summary of findings

349. Two NCAs (FR, IE) stated that they followed a risk-based approach regarding the review of policies and procedures. As a result of this approach, one NCA (IE) did generally not request or review policies and procedures, unless the relevant case officer saw a specific reason to do so. This NCA relied on information provided in a programme of operations. The other NCA (FR), generally also relied on information provided in the programme of activities. However, certain key policies were part of the application file of the larger sample case investigated by the PRC. Both NCAs (FR, IE) highlighted that the

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<sup>66</sup> Article 43(2)(b) of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).

<sup>67</sup> In particular, Article 9 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive) and Article 60 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).



programme of operations/activities provided by relocating entities include summaries and key elements of relevant policies and procedures and are legally binding documents.

350. Two other NCAs (LU, NL) required and reviewed key policies and procedures as part of the authorisation process, such as policies and procedures related to, inter alia, risk management, portfolio management, compliance, valuation and conflict of interest.

### **Analysis**

351. The PRC positively notes the thorough supervisory work of one NCA (LU) in relation to the Risk Management Process (RMP) and related documentation through comprehensive and, where possible, standardised assessments during the authorisation stage and follow-up regular desk-based and on-site inspections.
352. The PRC also positively highlights the detailed supervisory assessments conducted by another NCA (FR) on the envisaged portfolio management process, including the review of detailed order flows (pre-placement, validation and registration of orders and reconciliation of positions etc.).
353. The PRC recognises that a full supervisory assessment of all policies and procedures of applicant firms may not be feasible or effective given limited resourcing and time constraints. However, when assessing if, and in what way, relocating entities are aiming to comply with the applicable EU regulatory requirements in their organisation, the assessment of certain key policies and procedures, as specified in the IM Opinion, is necessary to mitigate the risk of applicant firms only promising but not actually putting in place the required sound governance arrangements. In this context, the PRC points out that in particular the initial and ongoing review of risk management policies is an explicit legal obligation of NCAs as set out in the EU legislation.<sup>68</sup>
354. The PRC therefore would have expected NCAs to review key policies and procedures during the authorisation stage as specified in the IM Opinion and relevant EU legislation. This concerns in particular policies and procedures relating to risk management, governance, conflicts of interest and delegation/due diligence in line with the guidance provided in the IM Opinion.

#### **4.3.1.1.4 Reporting to senior management and the board of directors**

355. NCAs are expected to assess whether senior management and members of the board of directors receive, on a regular basis, written reports on key issues.

### **Summary of findings**

356. All NCAs (FR, IE, LU, NL) had some supervisory practices in place to check the envisaged internal reporting mechanisms of applicant firms.

### **Analysis**

357. While all NCAs (FR, IE, LU, NL) had supervisory practices in place to check the envisaged internal and written reporting mechanisms, in general, not all NCAs (FR, IE) used checklists or other supervisory tools with a goal to verifying in a complete and

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<sup>68</sup> Article 39(3) of the Commission Directive 2010/43/EU (UCITS Level 2 Directive).

consistent manner that measures were put in place to ensure that all the reports listed in relevant EU legislation would be provided on a regular basis.<sup>69</sup>

358. Two NCAs (LU, NL) did use checklists or similar supervisory tools to provide for a comprehensive and practical overview of details on relevant internal written reports. However, the relevant checklists and supervisory tools used by one of these NCAs (NL) did not always reflect the final situation of the applicant firms at the date of authorisation. The other NCA (LU) did not collect the information set out in the checklist consistently for all applicant firms.
359. The PRC therefore invites all NCAs (FR, IE, LU, NL) to consider using a checklist or similar practical supervisory tools covering all responsibilities set out in relevant EU legislation to facilitate the supervisory assessments in this respect and ensure that these are utilised in a consistent manner.

### **Assessment**

360. Accordingly, the peer review assessment of NCAs is as follows:
- a. FR: largely meeting expectations.
  - b. IE: partially meeting expectations.
  - c. LU: fully meeting expectations.
  - d. NL: fully meeting expectations.
361. In terms of good practices, the PRC noted: that (i) one NCA (NL) uses detailed checklists covering the key legal requirements and paragraphs set out in the IM Opinion with a view to ensuring comprehensive and consistent supervisory assessments, (ii) another NCA (LU) assesses the Risk Management Process and related documentation particularly thoroughly through comprehensive and, where possible, standardised assessments, (iii) another NCA (FR) assessed the envisaged portfolio management process particularly thoroughly, including the review of detailed order flows (pre-placement, validation and registration of orders and reconciliation of positions etc.).

#### **4.3.1.2 Safeguards against conflicts of interest**

362. Paragraph 20 of the IM Opinion states that the allocation of responsibilities and functions within an authorised entity must be organised in a manner that avoids or mitigates conflicts of interest. Where authorised entities are part of a corporate group, this means that NCAs should be satisfied that there are no reporting lines to group functions or other individuals within the group that would contradict this principle or impair the independence of internal control functions.
363. Paragraph 21 of the IM Opinion states that NCAs should require detailed conflicts of interest policies and procedures and that NCAs should give particular consideration to any conflicts of interest which may arise when members of the governing/management body and, where it exists, supervisory function or staff members of authorised entities hold positions in other entities. In such case, NCAs should engage with the authorised

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<sup>69</sup> Article 9 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive) and Article 60 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).

entity and relevant persons in order to ensure that effective risk mitigation measures are taken.

364. In this context, the NCAs are expected to have a stringent supervisory approach in place regarding: (i) the segregation of responsibilities and functions that could, when combined, give rise to conflicts of interest, (ii) the existence and undue influence of reporting lines to the UK group and conflicts of interest management where group committees are used, (iii) conflicts of interest policies and procedures and (iv) dual hatting arrangements.

#### 4.3.1.2.1 Segregation of responsibilities and functions that could give rise to conflicts of interest

### Summary of findings

365. All NCAs (FR, IE, LU, NL) had in place a supervisory approach to the assessment of a combination of functions within relocating entities.
366. Most NCAs (IE, LU, NL) did not allow for a combination of risk management and portfolio management functions, while one NCA (FR) did permit this combination of functions under specific circumstances.<sup>70</sup>
367. All NCAs (FR, IE, LU, NL) did, albeit in some cases temporarily, allow for other combinations of internal control and operational functions (such as the combination of distribution/marketing and compliance or the combination of valuation and compliance/risk).
368. One NCA (FR) permitted a setup of a small fund manager in which the senior management was jointly responsible for all key functions. The NCA highlighted that several safeguards were in place, such as the “outsourcing” of operational compliance and internal controls tasks and the appointment of a third-party audit function, that included a review of the risk management function. In the case of a large fund manager, this NCA permitted a setup where the CEO was in charge of supervising controls and the valuation process and one senior manager was responsible for risk management and compliance. Risk and compliance functions were segregated at staff level.
369. Another NCA (NL) permitted the combination of risk management, valuation and business support functions. This NCA stated that this combination was usually not accepted, but it allowed the combination in some of the sample cases assessed by the PRC, arguing that this was acceptable because several other persons were involved in the valuation process and highlighting that this was a temporary arrangement that was rectified by the NCA at a later stage.
370. One NCA (IE) permitted a setup whereby the senior manager responsible for the Distribution/Marketing function was also responsible for the Compliance function. This NCA highlighted that this was a temporary arrangement that was rectified at a later stage.
371. Another NCA (LU) allowed governance setups that involved a combination of valuation, compliance and/or risk management functions. This NCA emphasised that additional risk mitigation measures, such as the involvement of an external independent valuation agent

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<sup>70</sup> In accordance with Article 15(1) AIFMD.

and different segregated teams dealing separately with valuation and risk issues, were in place and that the setup was only permitted temporarily.

372. All NCAs allowed the combination of risk management and compliance based on the principle of proportionality.
373. Where a combination of functions was allowed, NCAs stated this was justified based on the principle of proportionality.
374. More broadly, as part of their proportionality assessments, among using other criteria, NCAs used quantitative thresholds linked to the Assets under Management (AuM) of the applicant firm, which varied significantly between NCAs, ranging from €500 million to €10 billion, meaning that they were up to 20 times higher in one Member State compared to another.
375. Two NCAs (IE, LU), among assessing other criteria, used quantitative thresholds that were significantly above the median size of authorised fund managers across the EU (approx. €600 million AuM for authorised AIFMs as of end of 2021).
376. Furthermore, none of the NCAs (FR, IE, LU, NL) had in place detailed documented considerations regarding the application of the principle of proportionality, taking into account the nature, scale and complexity of the relocating entities to justify a combination of functions.
377. Where quantitative thresholds were considered, this was not the sole criterion and applicant firms could benefit from proportionality even where they were significantly larger in size. As a result of this, two NCAs (IE, LU) with high quantitative thresholds permitted a combination of certain functions and generally allowed for proportionality even for firms that had expected AuM that significantly exceeded the relevant quantitative thresholds. In this context, one NCA (LU) permitted, albeit on a temporarily basis, a combination of valuation, compliance and/or risk management functions for an applicant firm that exceeded the quantitative threshold. Another NCA (IE), permitted, albeit temporarily, a setup in which the senior manager responsible for the Distribution/Marketing function was also responsible for the Compliance function, whereas the expected AuM significantly exceeded the quantitative threshold.
378. Two NCAs (FR, IE) authorised relocating entities in which the organisational charts indicated reporting lines from both portfolio and risk management functions to one senior manager, which raises the question whether and how this structure complied with the requirement to have a functional and hierarchical separation between these two functions up to the governing body as set out in EU legislation.<sup>71</sup> According to these NCAs this governance structure is required by national corporate law. Moreover, one NCA (IE) emphasised that the risk management function of the relevant entity reported directly to the Board and that the relevant senior manager was not in a position to exercise undue influence on the risk management function.
379. In the same case, the NCA (IE) granted authorisation to an applicant firm in which a senior manager responsible for portfolio management was represented in the board of directors, whereas the senior manager responsible for risk management was not. This NCA highlighted that it is unusual for the senior managers responsible for risk

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<sup>71</sup> Article 42 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation) and Article 12 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive).

management to be represented in the board, but that non-executive directors, including independent non-executive directors, are on the board to ensure that the first and second line of defence operate independently.

## Analysis

380. None of the NCAs assessed (FR, IE, LU, NL) had in place a fully consistent and comprehensive assessment of potential and actual conflicts of interests including their management and disclosure to investors where required. The PRC therefore regrets that NCAs did not follow a more systematic and thorough approach to reviewing potential and actual conflicts of interest during the authorisation stage. This should be done on the basis of detailed documentary evidence provided by applicants that not only describe the potential and actual conflicts identified, but also how these are going to be managed. Moreover, applicants should be required to submit detailed information on all functional and hierarchical reporting lines within the organisation and to (UK) group entities including clear organisational charts to illustrate these. The PRC would have expected that NCAs scrutinised more closely the combination of responsibilities, roles, functions or reporting lines which may result in conflicts of interests or impair the principle of independence of control functions. In this context, reviewing the functional and hierarchical separation between portfolio and risk management throughout the entire governance structure up the governing body should have been done more rigorously. Even where a combination of functions that may give rise to conflicts of interest (e.g. risk management and operating units) is deemed proportionate due to the limited size, nature and complexity of the business activities, the applicable EU rules still require the implementation of safeguards against conflicts of interest. Inter alia, the minimum safeguards foreseen in the legislation require that the risk management function should be at least represented in the board with the same authority as the portfolio management function.
381. In this context, the PRC would like to highlight that the combination of responsibilities for operational (and therefore risk taking) and risk control functions impairs the independence of the latter and should be avoided as emphasised in the IM Opinion. If such a combination is justified based on the principle of proportionality, the PRC expects (i) documented considerations regarding proportionality based on which the combination of functions could be justified (ii) specifications regarding the circumstances and conditions under which the combination of functions was allowed (for example a condition in the authorisation letter that would only allow the aforementioned combination of functions during a specified period, and/or (iii) documented evidence of the safeguards put in place or detailed supervisory assessments regarding the mitigation of potential conflicts of interest.
382. The PRC is therefore concerned with the aforementioned combination of functions or responsibilities permitted by two NCAs (IE, LU). While the PRC understands that these combinations were permitted on a temporary basis, it did not find evidence for a detailed supervisory assessment of potential conflicts of interest and their adequate management during that period. Taking into account the size and broad range of complex business activities of the relevant entity in the sample cases, the PRC is of the view that some of the combinations permitted could not be justified based on the principle of proportionality. In addition, even where such combinations would be deemed proportionate, the EU legislation still explicitly requires the implementation of measures to mitigate conflicts of interest. Although various safeguards and mitigating factors might have been put in place

at some point to justify the combination of various functions, the PRC could not find evidence for the safeguards put in place at the start of operations and/or detailed supervisory assessments performed by NCAs regarding the effective mitigation of potential conflicts of interest in this context.

383. The PRC is also of the view that the quantitative thresholds that two NCAs (IE, LU) applied as part of the assessment of the principle of proportionality were too high and were not applied systematically in the sense that even applicant firms that significantly exceeded the NCA's internal thresholds were still permitted to combine potentially conflicting functions.
384. The PRC is concerned with the lack of supervisory convergence on this important issue as it creates an unlevel playing field and competitive distortions between market participants and raises the risks of regulatory and supervisory arbitrage.
385. Consequently, the PRC recommends that two NCAs (IE, LU) review the current thresholds. In the PRC's view any quantitative threshold considered as part of the assessments to determine whether proportionality could apply should also take into consideration the median size of entities across the EU/EEA (approx. €600 million for authorised AIFMs as of end of 2021). The PRC appreciates that different sizes of the fund management industry across NCAs may raise difficulties in setting a common quantitative threshold across all NCAs, nevertheless, NCAs are invited to take into consideration that this is the EU-wide median figure and that significant deviations from it might cause issues from a supervisory convergence perspective. Moreover, only entities of both (i) small size (in terms of AuM) and (ii) limited range of non-complex business should be able to benefit from the specific exemptions provided for in the AIFMD and UCITS framework based on the principle of proportionality.
386. Moreover, as noted in paragraph 378, the PRC is concerned that two NCAs (FR, IE) authorised relocating entities in which both portfolio and risk management functions had reporting lines to a single senior manager, arguing that this governance structure was required by their national corporate law. These arrangements raised the question whether and how they comply with the requirement to have a functional and hierarchical separation between these two functions up to the governing body as set out in EU legislation.<sup>72</sup> In light of this, the PRC is of the view that there would have been merit in performing more detailed supervisory analyses to ensure that these arrangements did not result in a contravention of the legal requirement to ensure a functional and hierarchical separation of portfolio and risk management.
387. In this context, there would have been merit in also assessing in more detail how the fact that the senior manager responsible for portfolio management was represented in the board of directors, whereas the senior manager responsible for risk management was not, ensured compliance with the legal requirement that safeguards against conflicts of interest should at least ensure that portfolio and risk management are represented in the governing body or the supervisory function, where it has been established, at least with the same authority as the portfolio management function.<sup>73</sup>

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<sup>72</sup> Article 42 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation) and Article 12 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive).

<sup>73</sup> In particular Article 43(1)(d) of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).

388. In light of the above, the PRC would have expected that these NCAs (FR, IE) reviewed in more detail the functional and hierarchical separation between portfolio and risk management throughout the entire governance structure up the governing body. Even where a combination of functions that may give rise to conflicts of interest (e.g. risk management and operating units) is deemed proportionate due to the limited size, nature and complexity of the business activities, the applicable EU rules still require the implementation of safeguards against conflicts of interest. Inter alia, the minimum safeguards foreseen in the legislation require that the risk management function should be at least represented in the board with the same authority as the portfolio management function.

#### 4.3.1.2.2 Group reporting lines and committee structures

389. NCAs are expected to assess reporting lines to group functions or other individuals within the group that would impair the independence of internal control functions. Equally, NCAs should review whether the use of (UK) group committees may give rise to potential conflicts of interest and in that case require applicant firms to implement measures to manage these risks.

#### **Summary of findings**

390. While all NCAs (FR, IE, LU, NL) required organisational charts that presented the internal reporting lines of the applicant firm, none of them consistently required group organisational charts or other documentation showing the existence of group reporting lines, and details on existing group reporting lines.

#### **Analysis**

391. The PRC regrets that none of the NCAs (FR, IE, LU, NL) put in place a proactive, systematic and comprehensive supervisory assessment of reporting lines of the local/EU head office to (UK) group entities with a view to avoiding or managing potential conflicts of interest as set out in paragraph 20 of the IM Opinion.

392. With respect to (UK) group committees, only one NCA (NL) performed a proactive, systematic and comprehensive supervisory assessment of the use of group committees and related conflicts of interest based on documented evidence.

393. Another NCA (LU) has generally assessed the composition, voting rights, role and agenda of (UK) group committees of relocating entities, where those existed. However, the evidence required and the analysis thereof, was not as consistent throughout the documentation provided.

#### 4.3.1.2.3 Conflicts of interest policies and procedures

#### **Summary of findings**

394. All NCAs (FR, IE, LU, NL) had supervisory approaches in place to review the conflicts of interest frameworks of applicant firms.

395. Two NCAs (LU, NL) requested and assessed the conflicts of interest policies and procedures of applicant firms, whereas two other NCAs (FR, IE) generally refrained from requesting and reviewing copies of these documents, but rather relied on self-confirmations, (high-level) summaries and descriptions of key elements.

## Analysis

396. The IM Opinion had highlighted the need to review certain key policies and procedures of relocating entities, focusing in particular on the policies and procedures relating to conflicts of interest, risk management, governance and delegation/due diligence which ESMA viewed as high-risk areas in the context of Brexit. The PRC regrets that none of the NCAs assessed (FR, IE, LU, NL) reviewed all key policies and procedures during the authorisation stage as specified in the IM Opinion.
397. With respect to the conflicts of interest policies and procedures specifically, one NCA (LU) sought evidence that showed that the applicant firm had conflicts of interest policies and procedures in place. However, the extent to which this NCA analysed and challenged the policies and procedures was not clear based on the information provided, as the sample cases did not demonstrate that the NCA challenged and investigated details on the mitigation of specific conflicts of interests of relocating entities. Furthermore, the PRC understands this NCA did not require applicant firms to submit conflicts of interest registers as part of the authorisation procedure. The PRC highlights the importance of gathering and reviewing documentary evidence of all actual and potential conflicts of interest and their envisaged mitigation (and required disclosures to investors, where relevant) during the authorisation stage.
398. Another NCA (NL) performed a thorough review of the conflicts of interest policies and procedures. Policies and procedures on the management of conflicts of interest including the actual conflicts register were requested and reviewed by this NCA, as these assessments were part of the checklist used. This NCA also demonstrated in the sample cases reviewed that it challenged and investigated details on the mitigation of specific conflicts of interests of relocating entities.
399. The two other NCAs (FR, IE) applied a risk-based approach that relied on self-declarations and (legally-binding) descriptions provided by applicant firms, without systematically requesting and reviewing the policies and procedures. These NCAs did also not require relocating entities to provide a conflict of interest register or other document describing actual and potential conflicts of interest and their envisaged mitigation (and required disclosures to investors, where relevant) during the authorisation stage.
400. One of these NCAs (FR) reviewed during the authorisation phase the group conflicts of interest policy of one of the sample cases. The PRC however noticed that the group policy did not specify that the applicant firm will also be in scope of the document. Moreover, local procedures and potential or actual conflicts of interests relevant to the applicant firm were not specified.
401. The other NCA (IE) received a very high-level conflict of interest registers in the two sample cases assessed by the PRC. However, the PRC noticed that these registers were identical. The PRC is therefore of the view that this indicates that the applicant firms did not apply a thorough analysis of potential and actual conflicts of interest in their specific organisation and business setups but merely relied on general descriptions and this should have triggered further supervisory assessments and challenge by the NCA.

### 4.3.1.2.4 Dual hatting



402. NCAs should have in place a supervisory approach to potential dual-hatting arrangements, whereby members of the governing/management body and, where it exists, supervisory function or staff members of relocating applicant firms envisaging to hold positions in other entities that may lead to potential conflicts of interests are subject to a supervisory assessment to ensure that these conflicts of interest are adequately managed.
403. In this context, the IM Opinion sets out that NCAs should give particular consideration to conflicts of interest arising from dual-hatting arrangements and engage with relevant entity and persons in order to ensure that effective risk mitigation measures are taken.<sup>74</sup> This primarily aims to ensure independence of the EU authorised entity.

### **Summary of findings**

404. All NCAs (FR, IE, LU, NL) generally investigated the various roles held by relevant individuals. However, all NCAs did permit various dual-hatting arrangements in different cases.
405. Only one NCA (FR) had in place specific (internal) criteria intended to limit the risk of potential conflicts of interest. These criteria related to, inter alia, time commitments to the applicant firm and the type of functions for which dual hatting was (not) permitted. However, this NCA (FR) allowed a setup whereby the CEO/President in the local entity held a dual position as deputy CEO in the (UK) group entity, which was also the delegate for portfolio management.
406. One NCA (NL) permitted a dual-hatting arrangement whereby the senior manager in charge of delegation monitoring in its member state appeared to be monitoring the portfolio management activities performed by himself in the UK, and this person was not remunerated by the local entity. The NCA highlighted that the license was granted with the condition that an additional portfolio management oversight manager should be hired as soon as business activities (either a new sub-fund or a new individual mandate) would increase and that this condition was subsequently met.
407. One NCA (LU) permitted a relocating entity to have a non-executive board of directors which was, at the time of authorisation, entirely composed of representatives from the UK parent undertaking (and delegate) and one local independent board member with over 41 other board mandates. This setup was considered acceptable by the NCA due to the type of mandates and the time spent on those mandates.
408. One NCA (IE) allowed some dual-hatting arrangements in some of the sample cases assessed, albeit only temporarily and confirmed that comingling of first and second line of defence roles is otherwise generally not permitted. Where the dual-hatting arrangements related to directors holding an executive role in one entity and a non-executive role in another (UK) group entity, this was permitted on a permanent basis.

### **Analysis**

409. For three NCAs (IE, LU, NL) the PRC did not find evidence of a detailed supervisory assessment of potential conflicts of interest arising from dual-hatting arrangements and their mitigating measures in this context.

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<sup>74</sup> Paragraph 21 of the ESMA Opinion.

410. Although the PRC notes that one NCA (FR) had some internal criteria intended to limit the risk of potential conflicts of interest did notice some considerations regarding dual-hatting arrangement in the sample cases, it regrets that the NCA did not perform more thorough assessment that clarified why the relevant roles could be combined without posing a conflict of interest or necessitating the implementation of mitigation measures.
411. The PRC is of the view that the aforementioned arrangement permitted by one NCA (NL) would have merited further supervisory assessments and challenge.
412. The PRC also regrets that one NCA (LU) permitted a relocating entity to have a board of directors which was, at the time of authorisation, entirely composed of representatives from the UK parent undertaking (and delegate) and one local independent board member with over 41 other board mandates. Taking into account the increased risks, the PRC would have seen merit in more detailed supervisory assessments or efforts to challenge the applicant firm in this respect.
413. While the PRC acknowledges that one NCA (IE) generally only allowed dual-hatting arrangements on a temporary basis, it did not find evidence for a detailed supervisory assessment of potential or actual conflicts of interest and their adequate management (and disclosure to investors, where required under the applicable rules) during the transitional period that was granted by this NCA.
414. In conclusion, the PRC regrets that all NCAs (FR, IE, LU, NL) did not scrutinise more closely the combination of responsibilities, roles, functions or reporting lines which could result in conflicts of interest, in particular in the case of dual-hatting arrangements.

### **Assessment**

415. Accordingly, the peer review assessment of NCAs is as follows:
  - a. FR: partially meeting expectations.
  - b. IE: partially meeting expectations.
  - c. LU: largely meeting expectations.
  - d. NL: largely meeting expectations.

#### **4.3.1.3 Adequacy of the role of internal control functions**

416. Paragraph 34 of the IM Opinion states that NCAs should be satisfied that the organisational policies and procedures of authorised entities provide for a strong role of the internal control functions within the organisation. Internal control functions should be consulted in particular before taking significant strategic decisions.
417. Paragraph 34 also states that the organisational policies and procedures of authorised entities should ensure that there is a clearly defined 'escalation procedure' in the case of disagreements between internal control functions and operating units. In the case of persisting disagreements at a higher level (e.g. disagreement between heads of unit), the final decision should be taken at the level of senior management. Where senior management or the governing/management body itself is in (persisting) disagreement on matters relating to compliance with the EU investment management legislation, the internal procedures should provide for an escalation to NCAs.

## Summary of findings

418. While all NCAs required a description of the internal control framework, two NCAs (FR, IE) did not request and review policies and procedures describing the involvement of internal control functions within various decision-making bodies.
419. All NCAs (FR, IE, LU, NL) approved setups under which the internal audit function was entirely performed by a group entity and there was therefore no internal audit function as such established within the authorised EU entity.
420. One NCA (FR) permitted a setup whereby one senior manager was responsible for internal control functions, while also exercising portfolio management activities. Furthermore, in one of the sample cases, the internal audit function was delegated to a third party which was also providing the compliance function for the relocating firm, meaning that the external third party provided both compliance (second level) and internal audit (third level controls). However, this NCA highlighted that it required the tasks to be assigned to distinct human resources within the third party in order to ensure independence between the various control functions.
421. None of the NCAs (FR, IE, LU, NL) required full compliance with the delegation rules set out in the AIFMD and UCITS Directive in the cases described above.
422. With respect to the need to implement escalation procedures as described in paragraph 34 of the IM Opinion, one NCA (LU) stated that it does not fully agree with the IM Opinion in this respect. It therefore did not review whether escalation procedures up to the NCA were implemented.
423. In this context, one NCA (IE) requires an INED as part of most board of directors which usually acts as the chair of the board. The NCA is of the view that this provides for necessary escalation possibilities.
424. Another NCA (FR) permitted a case with two senior managers and board members with equal decision-making rights (and equal shareholding). To ensure escalation possibilities this NCA ensured that an arbitration procedure was in place. In addition, the NCA (FR) noted that national law provides for escalation procedures in case of persisting disagreements.
425. One NCA (NL) stated that the national law requires an escalation to the NCA where senior management or the governing/management body is in a (persistent) disagreement on matters relating to compliance with the EU investment management legislation. However, this obligation is only applicable to AIFMs offering funds to retail investors.

## Analysis

426. The PRC could not find evidence that the NCAs (FR, IE, LU, NL) performed a detailed supervisory assessment and challenged applicant firms on the role and independence of the internal audit function. The separate concern of the application of delegation rules is covered in the section on delegation arrangements below.
427. The PRC also regrets that NCAs (FR, IE, LU, NL) did not perform a thorough supervisory assessment to ensure that the specific risks raised in paragraph 34 of the IM Opinion were addressed, in particular the requirement to ensure that control functions are adequately consulted before taking significant strategic decisions.

428. The PRC positively notes that indeed an INED as Chair of the board of directors as usually required by one NCA (IE) may provide for more independent decision-making process of relocating entities. Notwithstanding this, the PRC does not believe that this measure alone ensures that all supervisory expectations set out in the IM Opinion are met.
429. While the PRC acknowledges the assessments conducted by NCAs in terms of escalation procedures, it notes that the specific criteria laid down in the IM Opinion were not fully assessed by any of the NCAs. In this context, the IM Opinion highlighted that NCAs should be satisfied that the organisational structures of authorised entities ensure that also all material legal risks are assessed by individuals that have sufficient knowledge and experience in the relevant legal matters and are independent from risk-taking functions.<sup>75</sup> However, none of the NCAs assessed the arrangements of relocating entities in relation to the independent assessment of legal risks.
430. In conclusion, the PRC would see merit in NCAs (FR, IE, LU, NL) scaling up their efforts to review the establishment and strong role of internal control functions during the authorisation stage in line with the guidance provided in the IM Opinion.<sup>76</sup>

### **Assessment**

431. Accordingly, the peer review assessment of NCAs is as follows:
- a. FR: partially meeting expectations.
  - b. IE: partially meeting expectations.
  - c. LU: partially meeting expectations.
  - d. NL: partially meeting expectations.
432. In terms of good practices, the PRC noted that one NCA (IE) usually requires applicant firms to appoint an INED as Chair of the board of directors which provides for additional escalation possibilities and more independent decision-making processes.

## **4.3.2 Substance**

### **4.3.2.1 Sufficiency of human and technical resources**

433. NCAs are expected to assess the sufficiency of human and technical resources of the applicant firms in light of the supervisory expectations set out in paragraphs 27, 57 and 61 of the IM Opinion.

### **Summary of findings**

434. All NCAs (FR, IE, LU, NL) assessed and made requirements to ensure that each relocating entity has enough human resources, including at senior management level.
435. All NCAs required a minimum of two senior managers, however, the interpretation of the sufficiency of human and technical resources was different from one NCA to another.

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<sup>75</sup> Paragraph 31 of the IM Opinion.

<sup>76</sup> Paragraph 31 and 34 of the IM Opinion.

436. One NCA (FR) required each applicant firm to have a minimum of three employees, or an equivalent of three full-time positions, even for the smallest and simplest schemes. This NCA also considers that at least one of the two senior managers should be employed on a full-time basis. Moreover, this NCA stated that although the minimum number of employees was set at three FTE, for larger schemes additional resources proportionate to the nature, scale and complexity of the applicant firm were required.
437. Another NCA (IE) stated that it required a minimum of three persons (not necessarily representing three FTE) even for smaller entities with a limited range of non-complex business activities.
438. One NCA (NL) stated that its national corporate law requires a minimum of two board members that are working for the entity. Moreover, after feedback from the SCN, this NCA required relocating fund managers to have a minimum of three persons (not necessarily representing three FTE) overall, even for smaller entities with a limited range of non-complex business activities. The minimum of three persons, however, is not a legal requirement.
439. Another NCA (LU) required two senior managers and a minimum of three FTE even for smaller entities with non-complex business activities. If the size of the entity is above the threshold of €1.5 billion in terms of AuM, the NCA required applicant firms to have more senior managers and dual hatting is not allowed for at least two of them. To assess the sufficiency of human resources of the applicant firm, this NCA (LU) performed a comparison with the average of other fund managers of the same size in the domestic market. The senior managers effectively working in its member state (and residing in that member state or nearby) needed to represent the majority of the senior managers. Moreover, the major decisions must be taken locally. Based on the review of the floor map, the NCA also aimed to verify that the size of the offices was sufficient.
440. With respect to technical resources, all NCAs (FR, IE, LU, NL) noted of a large reliance of their local entities on the UK group.
441. Almost all sample cases assessed during the peer review demonstrated a large or complete reliance on the IT systems and tools established and maintained by group entities in the UK. In some of these cases, the applicant firms also relied on the UK entities for business continuity planning. In some other cases, the applicant firms entrusted IT tasks to specialised service providers in the EU.
442. In this context, one NCA (NL) highlighted that applicant firms usually externalised this function or use the group IT systems. The NCA considers this as an “insourcing” arrangement, not a delegation or secondment. In this case, the fund manager still remains responsible and the NCA checks whether the “support” by the service provider/group is appropriate. The NCA stated that it looked at the way the “support” was provided and if there was a risk of conflicts of interest and also required and assessed the contracts, the SLAs and checked whether the service provider had sufficient staff dedicated to provide an appropriate solution.
443. Another NCA (LU) stated that it is difficult for applicant firms to recruit IT staff in its member state. In terms of data storage, the market is increasingly moving to cloud solutions. The NCA, however, requires that there is back-up server in its member state so that the relevant data can be accessed at all times and recovered where needed.

## Analysis

444. Only one NCA (FR) fully met the supervisory expectations set out in the IM Opinion by performing a thorough supervisory assessments of the sufficiency of human and technical resources of applicant firms.
445. The cases approved by the other NCAs (IE, LU, NL) raised concerns for the PRC.
446. In one of the sample cases assessed, one NCA (IE) authorised an arrangement in which the senior management was seconded from another fund manager and White Label service provider in its member state. This case related to a large fund manager with over €80-90 billion AuM in the first year of authorisation that effectively employed two staff members, namely a senior manager and a personal assistant/office manager which were supported by five part-time secondees (each having seven to nine other mandates) from a White Label fund manager in the same member state and three “support staff” working at a group entity in the UK. Under this arrangement the seconded staff (i) assumed senior management responsibilities despite only allocating limited time to the relocating entity, (ii) was not based in the offices of the relocating entity, (iii) was still employed by the White Label service provider and (iv) did not have full/direct access to the systems of the relocating entity.
447. The NCA (IE) highlighted that this entity applied for an extension of its license six months after the initial authorisation and that it used this opportunity to require the recruitment of additional employees. Moreover, the NCA emphasised that its supervisory approach on this matter evolved over time, taking into account the outcome of discussions at the SCN and that it did not allow such arrangements for other relocating entities. Notwithstanding the improvements that were achieved ex post, this sample case raised significant concerns in terms of the sufficiency of human and technical resources at the start of operations. The PRC is of the view that the arrangements approved may not have met the applicable EU regulatory requirements as clarified in the IM Opinion.
448. In another case, this NCA (IE) authorised an applicant firm to manage €500 million AuM with 2,4 FTE despite performing a broad range of business activities and employing a variety of complex investment strategies (including long/short, mid and small caps, technology companies in US, ESG, Infrastructure, Global Equity, Total Return, Alternative credit including structured credit products, commercial and residential backed mortgages etc).
449. The PRC is of the view that these cases appeared problematic in terms of the sufficiency of human and technical resources as the vast majority of day-to-day business activities were still performed out of the UK despite the relocation. This observation was supported by the fact that up to 90% of the management fees generated by local entities in the sample cases assessed were paid to the UK group for the provision of portfolio management services. Similarly, the PRC observed cases where 80% of the distribution fees generated in the EU were forwarded to the UK group. The PRC believes that these high figures are indications for a lack of substance which would have merited further supervisory assessments by the NCA.
450. In another sample case, the relevant entity first considered relocating from the UK to one member state and already received an authorisation there (LU) and subsequently decided to re-relocate to another member state (IE). Despite a 400% increase in business activities in the latter member state (in terms of AuM) due to the additional management of UCITS, the human resources in the head office in this member state (IE) were slightly lower than what was agreed with the NCA in the former member state (LU).

The ultimate outcome (significantly more business in the new member state, but slightly lower resources than in the previous Member State) appears problematic. The PRC would have therefore seen merit in a more thorough supervisory assessment by this NCA (IE) and proactively reach out for a closer cooperation with the other NCA (LU) to review and verify that the re-relocation from one member state to another did not result in regulatory or supervisory arbitrage. However, the NCA (IE) emphasised that the entity built up significant resources in a branch in another member state (IT). At the same time, this setup posed additional questions as the human resources available in the branch in another member state (IT) significantly exceeded the human resources available in the head office (IE). In light of this, the PRC would have seen merit in more detailed supervisory analyses to assess potential regulatory and supervisory arbitrage risks.

451. Moreover, the PRC could not find evidence in the sample cases assessed of concrete supervisory efforts by this NCA (IE) to obtain detailed information from applicant firms on the existing setup and staffing of the relocating entities in the UK. To this end, the NCA was not in a position to comprehensively assess whether the relocating entities relocated their head office including the relevant staff to the EU as emphasised in the IM Opinion.
452. Another NCA (NL) authorised a large fund manager with over €33 billion AuM in the first year of authorisation to effectively delegate the entire portfolio management function and a broad range of the day-to-day risk management tasks to a UK group entity. Moreover, the local/EU entity signed a service agreement with the UK entity to benefit from services provided by the UK entity and its staff. This arrangement was not treated as a delegation arrangement. The middle and back-office functions were also delegated to a third-party service provider in that member state.
453. The PRC notes that this setup appeared to be a delegation arrangement and would have therefore merited further supervisory analyses and challenge to avoid a circumvention of the AIFMD/UCITS delegation and substance requirements. In this context, some of the substance-related supervisory assessments documented in the checklist prepared by the NCA (AFM) remained incomplete or were not set to “sufficient”. The letter box entity field in the checklist was even explicitly set to “insufficient”. The NCA explained that this was due to internal organisational issues but that the relevant checks and controls were completed.
454. The NCA (NL) also noted that the lack of resources was rectified at a later stage as the entity was subsequently required to hire one additional person for the risk management/oversight functions and that there are discussions pending with this entity as a merger is supposed to take place soon and the entity is expected to have more staff as a result of it, especially for the control functions.
455. The PRC highlights that the AIFMD and UCITS Directive look at the portfolio management and risk management functions to determine sufficient substance and require that a fund manager does not substantially delegate more portfolio and risk management functions than it retains. While the PRC acknowledges that the entity was an existing MiFID-licensed entity applying for AIFM authorisation with 35 staff members already employed, it is of the view that the additional staff hired to perform portfolio and risk management functions was not sufficient taking into account the amount, nature, broad range and complexity of the additional fund business. For the PRC, this case raised concerns in terms of the sufficiency of its human and technical resources and extent of delegation at the time of authorisation and would have therefore merited further analysis whether the substance requirements are met given the large-scale

delegation of both portfolio and risk management to the UK. This observation is supported by the fact that 50% to 80% of the management fees generated by the local/EU entity were paid to the UK entity for the provision of portfolio management services on a delegation basis. The PRC believes that these high figures are indications for a lack of substance which would have merited further supervisory assessments by the NCA.

456. In another sample case authorised by this NCA (NL), the applicant firm was authorised to manage more than €1.5 billion AuM with two senior managers, which were also board members, and one business administration support, representing overall less than three FTE in the local/EU applicant firm initially. In addition, a German branch was set up with four salespersons in two locations for distribution purposes only.
457. The PRC is concerned that there were less than three FTEs in the local entity taking into account the broad range of investment strategies (corporate bonds, global or European senior secured loans, emerging markets debts, emerging market core equity, government bonds, etc) employed by the entity. The responsibilities and time allocation of the senior managers and the board at the start of operations regarding the oversight of portfolio management functions delegated to the UK remained unclear to the PRC, also since the two board members in charge of the portfolio management oversight were required to step down as they were involved also in the investment teams within the UK group entity/delegate. The PRC also has concerns about the overall time dedication of the board in this case as only two of the four board members were fully dedicated to the entity at the start of operations, while the other two members were working 90% of their time for the UK group and were fully compensated by the UK group and not the local/EU entity. The PRC is of the view that this case appeared problematic in terms of the sufficiency of human resources as the vast majority of day-to-day business activities were still performed outside of the member state of authorisation and in fact outside of the EU. Moreover, the independence of the board appeared questionable given the circumstances described above.
458. Given the elevated risks in these cases, the PRC would have seen merit in the NCA (NL) requesting more detailed information from applicant firms on the existing setup and staffing of the relocating entities in the UK. To this end, the NCA was not in a position to comprehensively assess whether the relocating entities relocated their head office including the relevant staff to the EU as emphasised in the IM Opinion.
459. Another NCA (LU) provided a sample case with an already existing authorised AIFM in its Member State, managing €5 billion AuM in real estate, that applied for a change of the authorisation status for it to manage both AIFs and UCITS for an additional amount of €65 billion AuM in UCITS business (whereby portfolio management for the additional funds was fully delegated to the UK). The applicant firm was initially authorised with four senior managers, representing 2,15 FTE, one of them living in the UK and spending 20% of his time in the local/EU entity and 11 employees, already managing the initial €5 billion. The number of employees was expected to increase to 25 (including seven employees shared with another entity of the group) within six months after the authorisation. The NCA highlighted that the funds were onboarded after the six-months period and therefore after the recruitments were completed.
460. In terms of overall staffing, the NCA (LU) approved the setup on the basis of the expected increase of the number of employees which would take place at a later stage. The organisation in place at the start of operations, was in fact significantly below



(approximately half) the national average of employees for an entity of the same size in terms of AuM. Notwithstanding this, the setup was approved without further detailed supervisory assessments or challenge. The PRC also understands that there was no condition included in authorisation letter concerning the recruitment of the 14 additional staff members, but that the NCA expected to be updated on the recruitments to be made.

461. In another sample case, the applicant firm was authorised by this NCA (LU) to manage €2 billion AuM with less than five FTE locally (and eight FTE in an Italian branch dedicated to portfolio management in relation to non-performing loans) despite performing a broad range of business activities including some rather complex investment strategies. Four additional employees were to be recruited but the PRC understands that there was no condition included in the authorisation letter requiring these recruitments. The PRC also has concerns about the time dedication of the board in this case as it was entirely composed of representatives from the UK parent undertaking (and delegate) and one local independent board member with over 41 other board mandates. In light of these increased risks, the PRC would have seen merit in performing more detailed supervisory assessments or efforts to challenge the applicant firm in this respect.
462. The PRC recognises that limited time commitments could in some cases be justified on the basis of the principle of proportionality, taking into account the nature, scale and complexity of the activities of relocating entities, as well as the nature of a specific role. However, the PRC is of the view that the time commitments approved in the sample cases were too low at the start of operations in light of the size, nature and complexity of the envisaged business activities of the applicant firms.
463. Moreover, given the elevated risks in these cases, the PRC would have seen merit in the NCA (LU) requesting more detailed information from applicant firms on the existing setup and staffing of the relocating entities in the UK. To this end, the NCA was not in a position to comprehensively assess whether the relocating entities relocated their head office including the relevant staff to the EU as emphasised in the IM Opinion.
464. In conclusion, the PRC notes that none of the NCAs assessed, with the exception of one (FR) followed a supervisory approach to the review of the sufficiency of human resources employed by the applicant firms that fully met the supervisory expectations set out in the IM Opinion.
465. With respect to technical resources, the PRC positively notes that one NCA (FR) also paid particular attention to the technical resources of applicant firms as highlighted in the IM Opinion. For the other NCAs (IE, LU, NL) the PRC did not find evidence for more detailed supervisory assessments and would have therefore seen merit in a more thorough assessment of technical resources in order to meet supervisory expectations.
466. In conclusion, the PRC recommends to the other three NCAs (IE, LU, NL) introducing a more thorough review of the sufficiency of human and technical resources of applicants in line with the guidance provided by ESMA, in particular paragraphs 27, 57 and 61 of the IM Opinion.
467. In light of the findings, the PRC sees merit in more work at the EU level to assess the risk of EU market participants largely or fully relying on non-EU entities to provide the technical resources. This situation might also raise broader questions concerning the independence of the EU entity, compliance with the substance requirements, confidentiality/data protection and cybersecurity.

## Assessment

468. Accordingly, the peer review assessment of NCAs is as follows:

- a. FR: fully meeting expectations.
- b. IE: not meeting expectations.
- c. LU: partially meeting expectations.
- d. NL: not meeting expectations.

469. In terms of good practices, the PRC noted that one NCA (FR) assessed the technical resources of applicant firms particularly carefully. This NCA demonstrated to have a good overview of the various IT tools and systems used by applicant firms and their delegates.

### 4.3.2.2 Assessment of delegation arrangements

470. The IM Opinion requires NCAs to review the delegation arrangements focusing on (i) objective reasons for delegation, (ii) due diligence, (iii) delegation of internal control functions and (iv) risk of circumvention of delegation rules.

#### 4.3.2.2.1 Objective reasons for delegation

471. Paragraph 44, 45 and 62 of the IM Opinion states that NCAs should be satisfied that there are objective reasons for delegation and that overall delegation structure does not allow for a circumvention of the EU investment management legislation and responsibilities of the authorised entity.

## Summary of findings

472. All NCAs (FR, IE, LU, NL) received reasons from the applicant firms for the delegation. The applicant firms in the different relevant countries referred in a high-level manner to the need to ensure the continuity of the service provided to the clients and the available expertise and existing setup in the UK.

## Analysis

473. The PRC regrets that none of the NCA assessed (FR, IE, LU, NL) requested detailed descriptions, explanations and actual evidence of the objective reasons invoked, in contrast to what is referred to in the applicable AIFMD rules and highlighted in the IM Opinion and none of the NCA made a detailed supervisory assessment nor challenged the objective reasons of the envisaged delegation arrangements in the different sample cases.

474. In this context, NCAs argued that intragroup delegation arrangements would generally pose lower supervisory risks. Moreover, they did not focus on the objective reasons provided by applicant firms given the need to ensure business continuity and that this would have been in the best interest of investors.

475. The PRC acknowledges that the provision of services within the group may provide many benefits from the point of view of efficiency and sharing of expertise. Notwithstanding this, the PRC has concerns with the supervisory approaches followed by the NCAs in

scope of this peer review in this context, noting that the EU legislation does not provide for any derogations or exemptions in case of intragroup delegation arrangements. Conversely, the EU legislation in fact provides for specific requirements in the case of intragroup arrangements given the increased conflicts of interest.<sup>77</sup>

#### 4.3.2.2.2 Due diligence

476. Regarding the adequacy of the due diligence by relocating entities in case of delegation arrangements in light of the supervisory expectations set out in paragraphs 49 and 50 of the IM Opinion, the PRC observed divergent practices as not all NCAs requested and reviewed the due diligence policies and procedures on a systematic basis as set out in paragraphs 49 and 50 of the IM Opinion.

#### Summary of findings

477. Two NCA (LU, NL) requested the applicant firms to provide their due diligence policies and processes and also asked applicant firms whether an initial due diligence had been performed and sometimes requested examples when they had doubts but did not require on a systematic basis the initial written due diligence actually performed as set out in paragraphs 49 and 50 of the IM Opinion.

478. One NCA (LU) only requested confirmations from the applicant firms that an initial due diligence had been performed.

479. One NCA (FR) reviewed the delegation arrangements, including selection and monitoring processes, based on descriptions provided in the application documents provided by applicant firms (i.e. policies and procedures were generally not reviewed by this NCA). This NCA stated that intragroup delegation arrangements are generally perceived as low risk, resulting in a more limited review and challenge. Delegation arrangements with entities outside of the corporate group of the fund manager would generally be seen as posing a higher risk, for which evidence of both initial and ongoing due diligence would be required.

#### Analysis

480. None of the NCAs (FR, IE, LU, NL) asked applicant firms for proof that an initial due diligence was performed nor demonstrated that the specific due diligence-related expectations referred to in the aforementioned paragraphs of the IM Opinion were reviewed by them in a comprehensive and consistent manner.

481. Therefore, the PRC is of the view that NCAs did not meet the supervisory expectations set out in the IM Opinion.<sup>78</sup>

#### 4.3.2.2.3 Delegation of internal control functions

482. Paragraph 65 of the IM Opinion sets out that NCAs should request detailed information and evidence from authorised entities as to the objective reasons for the envisaged delegation of internal control functions. NCA should be satisfied that non-EU delegates have the required knowledge, expertise and experience and are up-to-date with EU investment management legislation and all regulatory requirements that apply to both

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<sup>77</sup> Article 80(1)(a) of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).

<sup>78</sup> Paragraph 49 and 50 of the IM Opinion.

the authorised entities and the funds managed by them. The latter is relevant also to the due diligence item mentioned above, where the PRC regrets that NCAs did not review the initial due diligence performed by applicant firms and therefore did not satisfy themselves that the envisaged delegates met the expectation set out in the IM Opinion.

483. Paragraph 67 of the IM Opinion sets out that NCAs should be satisfied that the risk management or delegation policies and procedures clearly specify the interaction between risk and portfolio management functions and are suitable in order to ensure that the risk management function can perform its activities in compliance with the EU investment management legislation.

### **Summary of findings**

484. Several NCAs (IE, LU, NL) permitted to partly or fully externalise internal control functions without detailed supervisory assessment or challenge of objective reasons behind the delegation arrangements and relied on brief descriptions from applicant firms rather than requesting and assessing detailed information, explanations and evidence of objective reasons as required under the applicable AIFMD delegation rules and emphasised in the IM Opinion.
485. One NCA (FR) generally did not allow a delegation of internal control functions. However, the secondment of staff in relation to compliance and internal control functions from a group entity could, under specific circumstances, be permitted. This NCA did grant authorisation to an applicant firm that had appointed a third party to provide both compliance and the internal audit functions. The setup in place was seen as 'outsourcing' and not treated as a delegation arrangement. While the PRC understands that the regulatory standards set out in the AIFMD and UCITS Directive do not apply in those cases, the NCA (FR) pointed out that the "outsourcing" of internal control function is still subject to national requirements relating to (i) selection process, (ii) contract settlement, (iii) monitoring process, (iv) assessments. In this context, the PRC highlights that the relevant legal provisions and supervisory expectations do not provide for the concept of 'outsourcing' or other 'support' arrangements without treating these as delegation arrangements.
486. One NCA (NL) authorised an applicant firm which delegated both the portfolio management and most of the day-to-day risk management functions to the same UK entity without receiving clear evidence to ensure that the risk management function in the local/EU entity could perform its activities in compliance with the EU investment management legislation.
487. Regarding the internal audit function, none of the NCAs assessed (FR, IE, LU, NL) required an internal audit function to be established within the authorised entities due to proportionality considerations but allowed applicant firms to effectively avoid the need to establish an internal audit function with relevant staff within the EU authorised entity by relying on UK group entities or other third parties outside of the group to perform the relevant controls.

### **Analysis**

488. None of the NCAs (FR, IE, LU, NL) provided evidence for a detailed supervisory assessment concerning the interaction between risk and portfolio management functions

to ensure that the risk management function can perform its activities in compliance with the EU investment management legislation as highlighted in the IM Opinion.

489. The PRC could also not find details on the assessment of the delegation and governance arrangements in place regarding the provision of the internal audit function by third parties, or by the UK group entities. Given the size, nature and complexity of the applicant firms in the sample cases in question, the PRC is of the view that the exemptions to the establishment of the internal audit function should not have been provided based on the principle of proportionality.<sup>79</sup>

#### 4.3.2.2.4 Circumvention of the delegation rules

490. The analysis in this context focused primarily on the use of internal or (UK) group committees, secondment arrangements and possible structures where applicant firms would not apply the delegation rules despite entrusting the performance of the functions set out in Annex I of the AIFMD and Annex II of the UCITS Directive to third parties.

### Summary of findings

491. In most sample cases assessed by the PRC, the applicant firms made a substantial use of (UK) group committees, secondment arrangements and/or “support” arrangements with UK entities (other than in a committee or secondments context), mostly without treating these as delegation arrangements, which raises the risk of circumvention of the AIFMD/UCITS delegation rules.
492. The PRC did not find evidence for detailed supervisory or legal assessments performed by the NCAs (FR, IE, LU, NL) in this respect.

### Analysis

493. The use of (UK) group committees, secondment arrangements and “support” arrangements would have merited more in-depth supervisory reviews with a view to minimising the risks of a possible circumvention of the AIFMD and UCITS delegation rules.
494. The PRC also observed supervisory approaches to the application of the AIFMD and UCITS delegation rules which appeared problematic, especially in intragroup constellations with varying national concepts (such as “outsourcing”, “insourcing”, “support”, “assistance”) which are not reflected in the EU legislation.
495. The PRC would like to point out that the delegation rules set out in the AIFMD and UCITS Directive apply to all cases where authorised fund managers entrust the performance of the functions set out in the AIFMD and UCITS Directive to third parties (whether within or outside their group).<sup>80</sup> The AIFMD Level 2 recitals provide for a narrow list of ‘supporting tasks’ that may not be subject to the delegation rules such as cleaning, catering or HR payroll support.<sup>81</sup> This narrow list of ‘supporting tasks’ does not encompass more substantial activities which require investment management-related expertise. In particular, this does not allow third parties (including group entities) to perform the functions set out in Annex I of the AIFMD and Annex II of the UCITS Directive

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<sup>79</sup> Also refer to Article 62 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation)

<sup>80</sup> Annex I of the AIFMD and Annex II of the UCITS Directive.

<sup>81</sup> Recital 82 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).

without these arrangements being subject to the delegation requirements. However, the NCAs assessed (FR, IE, LU, NL) authorised entities where the performance of more substantial tasks were externalised to third parties (within our outside of the group) without applying the delegation rules.

496. In light of this, the PRC regrets that the NCAs assessed (FR, IE, LU, NL) did not apply a more formalised and thorough supervisory approach to review envisaged delegation arrangements of applicants with a view to avoiding a circumvention of the delegation rules. Apart from the aforementioned review of committee structures and secondments, this also requires obtaining a better overview of the number and type of activities performed by third parties as part of so called “support” arrangements.
497. In light of the findings under this section, the PRC sees merit in more work at the EU level to improve supervisory convergence in relation to the supervision of delegation arrangements.

### **Assessment**

498. Accordingly, the peer review assessment of NCAs is as follows:
- a. FR: not meeting expectations.
  - b. IE: not meeting expectations.
  - c. LU: not meeting expectations.
  - d. NL: not meeting expectations.

#### **4.3.3 Monitoring of White Label service activity**

499. Paragraph 36 of the IM Opinion requires from NCAs allowing the activity of White Labelling to give special consideration to authorised entities engaged in such business and assess whether they continue to have sufficient human and technical resources to manage the additional business and comply with the applicable delegation requirements.

### **Summary of findings**

500. Among the four NCAs under review, only two (IE, LU) authorised White Label service providers.
501. The two other NCAs (FR, NL) confirmed that either they did not have any White Label service provider in their member state (NL) or any White Label service provider who had Brexit-related business (FR). However, the PRC observed that NCAs have divergent interpretations of what qualifies as White Labelling. It was therefore noted that further clarifications might be required to better understand what the notion of White Labelling precisely entails.

### **Analysis**

502. One NCA (IE), that has a significant White Label industry in its member state, performed a market survey on the Brexit relocation plans of all UK managers with domestic funds and all domestic fund managers with UK funds. In addition to analysing the survey results, this NCA engaged with relevant market participants and used the detailed notification and reporting mechanisms in place for new funds to identify the amount of

additional business gained by White Label service providers in its member state due to Brexit and also potential new entries into the White Label market. As a result of this supervisory work done, this NCA was able to provide the PRC with precise information and data on the evolution of the White Label industry in its member state throughout the Brexit period. As the data collected by this NCA indicated that entities providing White Label services in its member state did not gain significant business due to Brexit, the NCA did not need to carry out further supervisory work as set out in the IM Opinion.

503. Another NCA (LU), that also has a significant White Label industry in its member state, also performed a market survey to understand whether and to what extent relevant market participants under its supervision that might qualify as White Label service providers benefitted from additional Brexit-related business. However, this survey focusing on the business increase and the investments in human and technical resources was only performed in the second quarter of 2021 and therefore falls outside of the Review Period (from 1 June 2017 to 31 December 2020).
504. For the Review Period, this NCA was able to provide general aggregated figures on the size and evolution of the White Label service providers under its supervision but was not in a position to specify how much additional business was obtained by the White Label service providers under its supervision as a result of Brexit. Consequently, the NCA did not appear to specifically monitor this sector as stipulated in the IM Opinion. In addition, based on the sample case assessed, it seemed that this NCA did not always have a full overview of whether fund transfers by relevant entities represented White Label cases or not. This conclusion is supported by the fact that the NCA provided sample case documentation concerning a Brexit-related White Labelling arrangement which turned out not to be a White Labelling arrangement upon further investigation by the PRC. The PRC therefore recommends monitoring the White Label industry more closely given the specific supervisory risks posed.
505. In light of the above, notably the doubts expressed by some NCAs as to the general definition or concept of White Labelling, the PRC sees merit in more work at the EU level to improve supervisory convergence in relation to the authorisation and supervision of fund managers providing White Label services.

## **Assessment**

506. Accordingly, the peer review assessment of NCAs is as follows:
  - a. FR: N/A.
  - b. IE: fully meeting expectations.
  - c. LU: not meeting expectations.
  - d. NL: N/A.

## 4.4 Assessment and recommendations tables

### 4.4.1 Assessment by the PRC

507. 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.

508. Although the recommendations are addressed to the six NCAs covered by this peer review, all NCAs are invited to consider whether the recommendations made in this report may also apply to their authorisation and supervisory practices. Indeed, the PRC considers that the evolving business models of entities across all industry sectors (e.g. increasing reliance on technology) and the consequences in terms of groups’ organisation, governance, outsourcing and staffing practices – which were observed in the context of Brexit relocations’ authorisations – could be considered a more general trend.

**TABLE 5 – ASSESSMENT OF NCAS**

#### MIFID FIRMS

		CY	DE	IE
<b>Governance</b>				
	Knowledge, expertise and commitment to the firm			
	Meaningful presence in the MS of establishment			
	Conflicts of interest			
	Board members & senior management			
<b>Substance</b>				
	Choice of MS of relocation			
	Human & technical resources			
	Outsourcing			
	Independence of internal controls			

#### TRADING VENUES

		FR	IE	NL
<b>Governance</b>				
	Independence of board members & senior management			
	Impact of outsourcing on decision making powers and related risks			
	Cost and Benefit Analysis and due diligence applied to service providers			
	System resilience and internal controls			
<b>Substance</b>				



	Human & Financial resources			
	Outsourcing of key & important functions			
	Effective supervision of outsourcing arrangements with third-country service providers			

## FUND MANAGERS

		FR	IE	LU	NL
<b>Governance</b>					
	Independent and effective decision-making				
	Safeguards against conflicts of interest				
	Adequacy of the role of internal control functions				
<b>Substance</b>					
	Sufficiency of human and technical resources				
	Assessment of delegation arrangements				
	Monitoring of White Label service activity	N/A			N/A

<b>Fully meeting expectations</b>	<b>Largely meeting expectations</b>	<b>Partially meeting expectations</b>	<b>meeting</b>	<b>Not meeting expectations</b>
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### 4.4.2 Recommendations by the PRC

509. 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 that could be subject to a follow-up<sup>82</sup> two years from the publication of this report are marked “open”.

510. The recommendations aim at strengthening the authorisation process of the NCAs, without being limited to the Brexit one-off event. In addition to the recommendations addressed to NCAs, some cross-cutting recommendations are identified for follow-up work at EU level.

511. Although recommendations relate to broadly the same topics, they are made for each of the three sectors covered by the peer review i.e. MiFID firms, trading venues and fund managers, taking into account the regulatory framework applicable to each sector.

512. The PRC would like to stress that this peer review aimed to identify some points for attention which might not only be relevant to the NCAs participating to the exercise but generally to all NCAs in the EU. In fact, the PRC considers that the evolving business models of entities across all industry sectors (e.g. increasing reliance on technology) and

<sup>82</sup> under article 16 of Regulation (EU) No. 1095 /2010 and the Methodology

the consequences in terms of groups' organisation, governance, outsourcing and staffing practices – which were observed in the context of authorisations linked to Brexit relocations - could be considered a more general trend. Under this perspective, the PRC invites all NCAs to consider whether the findings and recommendations made in this report may also apply to their authorisation and supervisory practices.

Table 6 – RECOMMENDATIONS

Topic	NCA / Recommendation	Follow up
<b>MiFID firms</b>		
<b>General - DE</b>	Setting a framework with criteria to decide when to require an audit report and/or a notification from the firm and its timeframe.	Open
<b>Governance – DE</b>	Applying a higher materiality threshold regarding alternative arrangements under Article 9(6) of MiFID II.	Open
<b>Governance – DE, CY</b>	Implementing minimum thresholds in terms of expected time commitments from senior managers to the management of the firm.	Open
<b>Governance – DE, CY</b>	Considering carefully situations of dual hatting to address any potential conflicts of interests that may result from it.	Open
<b>Governance – DE, CY</b>	Ensuring that all applicant firms have a conflict of interest policy in place prior to authorisation. <sup>83</sup>	Open
<b>Governance – DE, IE, CY</b>	Reviewing the conflict of interest policy of all applicant firms prior to authorisation. <sup>84</sup>	Open
<b>Substance - DE</b>	Assessing thoroughly the extent of outsourcing by an applicant firm to prevent the delegation of functions/services to an extent that the firm becomes a letter-box entity, in particular in situations where the applicant firm would perform substantially more investment services functions from outside its Member State of establishment. <sup>85</sup>	Open

<sup>83</sup> ESMA35-43-762, paragraph 35.

<sup>84</sup> ESMA35-43-762, paragraph 35.

<sup>85</sup> ESMA35-43-762, paragraph 43.

<b>Substance - DE</b>	Ensuring that outsourcing arrangements are in place at the moment of the authorisation or, at the very least, at the commencement of operations.	Open
<b>Substance – DE, CY, IE</b>	Increasing scrutiny before allowing the combination of control functions with other functions (for instance, executive, operational or other control functions), to ensure such control functions remain effective.	Open
<b>Substance - CY</b>	Accruing scrutiny on outsourcing arrangements to group entities as such arrangements are susceptible of leading to enhanced conflicts of interests.	Open
<b>General - DE</b>	Implementing a formal process for recording all conditions of authorisation	Open
<b>General – DE, CY</b>	Implementing a formal process to ensure follow up regarding the phasing out of transitional arrangements.	Open
<b>Trading venues</b>		
<b>General – FR, NL</b>	Better framing the use of proportionality in the authorisation process and the establishment of a clearer set of concrete minimum obligations.	Open
<b>General – IE, NL</b>	Undertaking, where conditional authorisation is used, systematic controls and checks to ensure all conditions are fully satisfied before the start of operations.	Open
<b>General – FR, IE</b>	Involving more systematically and formally IT expert during the authorisation process.	Open
<b>Governance – FR, NL</b>	Setting clear minimum authorisation requirements and standards with respect to the overall governance structure of trading venues in particular regarding dual-hatting, time commitment, functional reporting lines and policies, procedures and rulebooks to ensure that beyond the formal decision-making powers, there are safeguards in place to limit the actual influence of the group.	Open
<b>Governance – FR, NL</b>	Undertaking concrete controls and checks during on-going supervision regarding the effectiveness of the decision-making powers that lie with the board, senior managers and key function holders of the trading venues.	Open

<b>Governance</b> <b>FR, NL, IE</b>	- Applying for both authorisations and on-going supervision controls and checks (e.g. CBA or due diligence process) that are typically required for outsourcing of activities to third party providers also to intra-group outsourcing taking, where necessary, the specific nature of intra-group outsourcing into account.	Open
<b>Governance</b> <b>IE</b>	- Better assessing the risks relating to outsourced activities at the authorisation stage and systematically review the policies and procedures, specifically the documents related to the management of risks by relocating trading venues and outsourcing (for instance, SLAs, BCPs and DRPs).	Open
<b>Substance</b> <b>FR, NL, IE</b>	- Better monitoring, as part of the on-going supervision, the magnitude of outsourcing with a view to establish a more balanced repartition between activities performed outside and inside the EU considering the number of staff, for key and important functions in particular, the percentage of revenue that is paid back for the performance of outsourced activities and the overall organisational set up.	Open
<b>Substance - IE</b>	- Dedicating more efforts to have more activities (including technical activities) being relocated, specifically for voice brokerage platforms during authorisations and as part of on-going supervision.	Open
<b>Substance</b> <b>FR, NL, IE</b>	- Carefully monitoring during on-going supervision the contractual arrangements (secondment contracts for brokers in particular) to ensure that those do not impair the overall independence of the trading venues and that relocated staff are systematically replaced by local staff at the end of the secondment period.	Open
<b>Fund Managers</b>		
<b>Governance</b> <b>(FR, IE)</b>	- Introducing a more comprehensive and systematic approach to identifying and analysing compliance with the legal requirements <sup>86</sup> during the authorisation stage. <sup>87</sup>	Open

<sup>86</sup> As set out in Article 9 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive) and Article 60 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).

<sup>87</sup> The NCA assessments in this context should be based on documentary evidence provided by applicants (e.g. in the form of detailed policies and procedures, terms of reference of internal or group bodies, etc...).

<b>Checklists (FR, IE, LU, NL)</b>	Consider introducing or using more consistently a checklist (or similar supervisory tools) covering all responsibilities <sup>88</sup> to facilitate the supervisory assessments in this respect and ensure that these are performed in a complete and consistent manner.	For consideration
<b>Policies and procedures (FR, IE)</b>	Requesting and reviewing key policies and procedures during the authorisation stage as specified in the IM Opinion. This concerns in particular policies and procedures relating to risk management, governance, conflicts of interest and delegation/due diligence in line with the guidance provided in the IM Opinion.	Open
<b>Committee structures (FR, IE, LU, NL)</b>	Reviewing the use of internal and (UK) group committee structures during the authorisation stage to ensure that they do not result in any circumvention of applicable regulatory requirements, in particular the requirements on the clear allocation of responsibilities of senior managers/board of Directors, conflicts of interest and delegation requirements. <sup>89</sup>	Open
<b>Conflicts of interest (FR, IE, LU, NL)</b>	Introducing a more systematic and thorough approach to reviewing potential and actual conflicts of interest during the authorisation stage including conflicts arising from dual-hatting arrangements. <sup>90</sup> Scrutinising more closely the combination of responsibilities, roles, functions or reporting lines which may result in conflicts of interest or impair the principle of independence of control functions. <sup>91</sup>	Open
<b>Proportionality (IE, LU)</b>	Reviewing the current proportionality standards applied. <sup>92</sup>	Open

<sup>88</sup> As set out in the Article 9 of the Commission Directive 2010/43/EU (UCITS Level 2 Directive) and Article 60 of the Commission Delegated Regulation (EU) No. 231/2013 (AIFMD Level 2 Regulation).

<sup>89</sup> This review should be based on documentary evidence provided by the applicants (e.g. in the form of detailed policies and procedures, terms of reference, minutes of existing committees etc).

<sup>90</sup> This should be done on the basis of detailed documentary evidence provided by applicants that not only describe the potential and actual conflicts identified, but also how these are going to be managed and disclosed to investors, where required.

Moreover, applicants should be required to submit detailed information on all functional and hierarchical reporting lines within the organisation and to group entities including clear organisational charts to illustrate these.

<sup>91</sup> In this context, reviewing more rigorously the functional and hierarchical separation between portfolio and risk management throughout the entire governance structure up the governing body. Even where a combination of functions that may give rise to conflicts of interest (e.g. risk management and operating units such as portfolio management) is deemed proportionate due to the limited size, nature and complexity of the business activities, the applicable EU rules still require the implementation of safeguards against conflicts of interest. Inter alia, the minimum safeguards foreseen in the legislation require that the risk management function should be at least represented in the board with the same authority as the portfolio management function. Therefore, performing more detailed supervisory reviews in this respect.

<sup>92</sup> Any quantitative threshold applied to determine whether proportionality could be applied in the cases foreseen in the EU legislation should give consideration to the median size of entities across the EU (approx. €600 million for authorised AIFMs as of end of 2021). For the avoidance of doubt, this does not necessarily mean that the threshold should be fixed at €600 million, but NCAs are invited to take into consideration that this is the EU-wide median figure and that large deviations from it could cause issues from a supervisory convergence perspective. Moreover, only entities of both (i) small size (in terms of AuM) and (ii) limited range of non-complex business should be able to benefit from the specific exemptions provided for in the AIFMD and UCITS framework based on the principle of proportionality.

<b>Role of internal control functions (FR, IE, LU, NL)</b>	Scaling up the efforts to review the establishment and strong role of internal control functions during the authorisation stage <sup>93</sup> .	Open
<b>Human and technical resources (IE, LU, NL)</b>	Introducing a more thorough review of the sufficiency of human and technical resources of applicants <sup>94</sup> .	Open
<b>Delegation arrangements (FR, IE, LU, NL)</b>	Introducing a more formalised and thorough supervisory approach to reviewing the overall business setup and envisaged delegation arrangements of applicants to avoid a circumvention of the delegation rules. <sup>95</sup> Introducing a more thorough review to verify that envisaged delegation arrangement of applicants and authorised entities are based on objective reasons <sup>96</sup> . Scaling up the efforts to review that envisaged delegation arrangements in relation to the internal control functions are based on objective reasons and do not impair the effectiveness of the relevant control functions or their independence <sup>97</sup> .	Open
<b>Monitoring of White Label service activity (LU)</b>	Monitoring the White Label industry more closely given the specific supervisory risks posed.	Open

#### 4.4.3 Cross-cutting issues and recommendations

513. The PRC identified cross-cutting issues that would merit further work at EU level to foster supervisory convergence. They relate mainly to the application of (i) the risk-based approach, (ii) the proportionality principle, (iii) outsourcing / delegation arrangements and (iv) the definition of fund managers providing White Label services.

514. All NCAs, to different degrees, applied a risk-based approach. However, the PRC observed that NCAs have different interpretation as to what constitutes a risk-based approach. In some instances, this risk-based approach led to outcome that to the PRC's view may not have been in line with the requirements provided under the ESMA Opinions.

515. In addition, the PRC observed a case by case application of the proportionality principle (often with no concrete thresholds or set criteria).

<sup>93</sup> in line with the guidance provided in the ESMA Opinion, in particular paragraphs 31 and 34.

<sup>94</sup> In line with the guidance provided by ESMA, in particular paragraphs 27, 57 and 61 of the ESMA Opinion.

<sup>95</sup> Apart from the aforementioned review of committee structures and secondments, this also requires obtaining a better overview of the number and type of activities performed by third parties.

<sup>96</sup> In accordance with the guidance provided by ESMA, in particular paragraphs 44, 45 and 62 of the ESMA Opinion.

<sup>97</sup> In line with the guidance provided by ESMA, in particular paragraphs 65 and 67 of the ESMA Opinion

516. The use of the risk-based approach and the application of proportionality have, in many instances, led NCAs to only impose in practice very minimal requirements, in particular to smaller firms.
517. Finally, a varied approach on the use of outsourcing/delegation arrangements was observed across the three areas, as well as a varied understanding of the concept of White Label services in the fund manager area.
518. Some sectoral recommendations provided above aim at addressing these issues to the extent permitted in the scope of the peer review. However, given the nature of the cross-cutting issues, further work at EU level could help to foster convergence.

## 4.5 Good Practices

519. The PRC identified good practices with regard to NCAs' as presented in the table below. All NCAs are invited to consider these good practices to assess how to endorse them to further enhance their authorisation process.

**TABLE 7 – GOOD PRACTICES**

Area	Topic	Good practices
<b>MiFID firms</b>		
Transversal	n/a	Before applicant firms submitted their application for authorisation, holding extensive preliminary discussions, sometimes even workshops, with applicant firms to convey BaFin's expectations and better understand applicant firms' planned set up (DE).
Governance	Knowledge and expertise and commitment to the firm	Conducting interviews with key function holders and shareholders to assess their suitability (CY).
		Conducting, for all authorisation applications, an on-site inspection prior to granting the authorisation to ensure that substance and all required conditions are met (CY).
		Depending on the category of the applicant firm, conducting interviews with applicants for certain pre-approved functions (IE).
	Meaningful presence in the Member State of establishment	Requiring at least two senior managers to be residents in the Republic of Cyprus (CY).
		For significant firms, requiring the control functions to be located within the Republic of Cyprus (CY).
Substance	Resources	For all firms, including in the authorisation letter the obligation to liaise with the NCA if their activities increase by

		more than a certain percentage from the projections initially submitted in the business plan (CY and IE).
<b>Trading venues</b>		
Transversal	n/a	Organising a pre-scanning phase (pre-meetings with possible applicants) which allowed to anticipate on possible issues which could have emerged during the authorization procedure and to get more familiar with the business model of possible applicants.
Governance	Independence of board members & senior management	Adopting a two-step approach for fit and proper checks assessing CVs at authorisation stage and conducting licensing interviews for a subset of staff six months after the start of operation (FR).
		Conducting more in-depth checks and controls regarding possible existing conflicts of interest for functions benefitting from the status of Pre-Approved Control Functions – notably board members and heads of risk and compliance (IE).
		Setting clear obligations regarding board members including requiring an INED as Chair of the board, with no possibility for derogation (IE).
		Not allowing dual hatting for certain functions (typically for executive directors and compliance and risk officers) (IE).
	Impact of outsourcing on decision making powers and related risks	Requesting entity specific SLAs (IE).
		Reviewing the staff dedicated, within the group, to the performance of outsourced activities (FR).
		Imposing measures to mitigate operational risk such as non-intermediated kill switches, local disaster recovery site (IE).
	Cost and Benefit Analysis and due diligence applied to service providers	Appointing a specific person in charge of the outsourcing oversight (FR, IE, NL).
		Ensuring that the price paid for services outsourced to entities within the same group remained fair and was not used to transfer profits outside the EU (FR).
	System resilience and	Using a work programme which is listing all relevant requirements (EU and domestic requirements) as well as the guidance that the NCA's assessment officers needed to



	internal controls	follow during the authorisation process, with a tab dedicated to resilience and IT issues (NL).
		Requiring the submission of a first RTS 7 self-assessment during the authorisation phase and of a questionnaire on IT risks to all applicants (IE).
		Adopting a six-eyes review approach for issues relating to systems' resilience involving the IT team, the authorisation assessment officers and the relevant supervisors (NL).
Substance	Outsourcing of key & important functions	Requiring having voice brokers located in the jurisdiction (FR).
		Requiring tailored policies, procedures and rulebooks (FR, IE).
<b>Fund Managers</b>		
Governance	Independent and effective decision-making	Using detailed checklists covering the key legal requirements and paragraphs set out in the IM Opinion with a view to ensuring comprehensive and consistent supervisory assessments (NL).
		Conducting a detailed review of the envisaged portfolio management process, including the review of detailed order flows (pre-placement, validation and registration of orders and reconciliation of positions etc.) (FR).
		Thorough review of the Risk Management Process and related documentation particularly through comprehensive and, where possible, standardised assessments (LU).
	Adequacy of the role of internal control functions	Requiring applicant firms to appoint an INED as chair of the board of directors provided for additional escalation possibilities and more independent decision-making processes (IE).
Substance	Sufficiency of human and technical resources	Comprehensive assessment of the technical resources of applicant firms to obtain a good overview of the various IT tools and systems used by applicant firms and their delegates (FR).



## Annex 1 - Mandate



Brexit Peer Review  
Mandate.pdf

## Annex 2 – Questionnaire



Brexit Peer Review -  
Questionnaire.pdf

## Annex 3 - Statements

### 1. Statement from the Autoriteit Financiële Markten (NL)

The AFM shares the objectives of ESMA’s “Peer review into the NCAs’ handling of relocation to the EU in the context of the UK’s withdrawal from the EU” and welcomes this important piece of supervisory convergence work.

Brexit was an unprecedented development and brought on a lot of uncertainty to the capital markets amidst political turmoil. Due to the collective, strenuous efforts of ESMA (through the Supervisory Coordination Network, SCN) and national competent authorities (NCAs), the Brexit transition went smoothly, with no significant impact on financial stability.

Robust and consistent authorisation standards are crucial for the protection of investors and the proper functioning of the single market. The AFM has endeavoured to meet all the supervisory requirements, while taking into account the input expressed by ESMA and other NCAs in the coordination up to Brexit. The report has identified limitations to NCAs’ supervisory processes at the time Brexit took place. This relates to areas such as outsourcing, delegation and adequate contractual staffing; topics that require further discussions and would benefit from a common European approach. The AFM would like to underline that the AFM met all supervisory expectations expressed by the SCN at the time of approval of licenses. The AFM continues to monitor and supervise the market activities on the ground.

We embrace this exercise first and foremost as a peer learning experience to further converge our supervisory approaches in pursuing a harmonised approach. In that light, the AFM finds it important to remain outcome-focused and pragmatic in our overall approach. We deem it important that peer reviews apply the regulatory framework as is agreed upon by ESMA and the NCAs. Given that the outcomes of this peer review demonstrate there remain divergences in the interpretation or application of the rulebook, the AFM would very much welcome further



convergence work on these important topics. We would appreciate ESMA taking a leading role in such further discussions.

## 2. Statement from the Autorité des Marchés Financiers (FR)

AMF shares the objectives of this Peer Review and measures its importance to reach convergence in Europe toward the relocated entities. As a general remark, AMF supports the work that have been done, at the Supervisory Coordination Network and through the Peer Review, especially using samples of real life cases.

Throughout the Brexit period, AMF took a firm stance in relation to Human and financial resources and organisation, and used the interpretation provided during the SCN in its authorisation processes and considers it adheres to the principles set in the ESMA opinions. For Asset management, AMF have ensured a proper separation of functions through Responsible Officers ('Dirigeants Effectifs'), all authorized by the AMF, individually in charge of the relevant key functions (asset management, compliance / internal control and risk management). AMF also have already access to key policies and procedures through the activity program, a higher value document, legally binding and enforceable. For trading venues, AMF made sure that key important functions such as surveillance, risk and IT control functions are adequately represented in the EU entity. AMF also took a strict approach and imposed that voice-based brokers executing transactions on behalf of EU clients are located in EU. AMF will have a pragmatic approach when following-up on the recommendation to seek a more balanced distribution of staff between EU and outside EU, that should not be interpreted as preventing firms to centralise their IT Operation teams in a centre of excellence, provided outsourcing arrangements are closely monitored. AMF considers that the report could have better prioritized its conclusions and recommendations, helping putting the focus on the most critical and important issues, i.e. the compliance of the authorized set ups with regard to EU law. We view in particular the issue of substance to be of paramount importance, and welcome the report's conclusion and recommendation in that regard. In contrast, we feel some technicalities related to the way the NCAs have dealt internally with the relocations (check-lists, procedures) should have been less emphasized in the report.

AMF also wants to highlight what we believe is a material error regarding the conclusions on dual hatting. While all NCA have authorised dual hatting in different forms, the PRC identify only AMF good practice, yet, not reflected in the rating.

AMF welcomes this report and its follow-up, especially for addressing cross-cutting issues in a risk-based and outcome focus approach.

## 3. Statement from the Central Bank of Ireland (IEI)

The Central Bank of Ireland (CBI) strongly supports ESMA's objective to achieve greater supervisory convergence, and the importance of Peer Reviews in this context as a tool to help identify best practice and raise standards. We would like to thank the Peer Review Committee (PRC) for their work and constructive engagement throughout the Peer Review. Robust and consistent authorisation standards are crucial for the protection of investors and the proper functioning of the single market.



Throughout the Brexit period, the CBI took sustained action to improve our processes and expectations for authorising fund management companies, taking into account in particular our active participation and engagement with ESMA's Supervisory Convergence Network (SCN). The Peer Review covered three sectors and as a result was only able to include a limited number of sample cases for each sector. As noted in the report the governance structure and resources of the two Fund Management Companies sample cases for the CBI had already been amended prior to the Peer Review. As a result, the Peer Review findings for Fund Management Companies do not accurately represent the high standards applied by the CBI or the positive outcomes achieved by the rigorous and substance-focused authorisation processes that evolved significantly over the course of Brexit.

The limited scope of the review and the narrow focus on a single point in time have resulted in findings that taken together incorrectly reflect the substantive outcomes. In particular, the report does not recognise that, while Brexit was a uniquely complex and unprecedented event, the collective efforts of ESMA and national competent authorities ensured the successful transition of activities with minimal disruption to investors.

The CBI welcomes the fact that the report calls out the key role that ESMA has in driving the discussion on the cross-cutting issues of (i) a risk-based approach, (ii) the proportionality principle and (iii) outsourcing / delegation arrangements, all of which require follow-up work at EU level.

#### 4. Statement from the Commission de Surveillance du Secteur Financier (LU)

The CSSF welcomes ESMA's work in the area of supervisory convergence, and that the Peer Review has permitted to identify some cross-sectorial issues, like the risk-based approach, (ii) the proportionality principle and (iii) outsourcing/delegation arrangements where additional convergence work may be done at European Level.

The CSSF had also welcomed and actively participated in the Supervisory Coordination Network ("SCN") implemented post Brexit with the objective of avoiding brass plate operations with no or little substance, that would be set up by UK firms to enable them to benefit from the EU single market. The CSSF has actively participated in the SCN by attending all 27 meetings with two senior staff, and by presenting all of 40 fund management authorization files that could be related to Brexit. Key aspects of such files were presented in detail to both ESMA staff and the other 27 NCAs, covering amongst others organizational/setup aspects of the relocating entities, including details on staffing, split of responsibilities between senior managers, the organization of the control functions, the projected business volumes and the delegated functions. After no serious objections had been raised, respectively solving any concerns highlighted by the SCN members, the authorization process proceeded as per the CSSF's ordinary requirements.

The CSSF regrets that the Peer Review Report does not in all cases factually reflect the organization in place of the selected funds managers and that it contains assumptions, for example on the existence of a proportionality threshold, that are inaccurate.



The CSSF disagrees with the conclusion of the Peer Review on the “white label service provider”. The Luxembourg white label sector was subject to supervisory work, namely through the review of license extensions and onsite inspections, during the review period. Moreover, a survey done by the CSSF has shown that the business increase resulting from Brexit was only marginal in comparison with the total assets under management domiciled in the Luxembourg market.

The CSSF is surprised by some of the findings now raised by the peer review committee, and expresses strong disagreement with both the overall process and some of the individual findings.

The CSSF believes that weaknesses identified across the jurisdictions reviewed should form the basis for further convergence work, respectively to elaborate or review existing guidelines or other instruments, and where and if appropriate, suggest amendments to Level 1 texts.