

**Deloitte.**



**Industry Regulatory Update**  
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# Speaker



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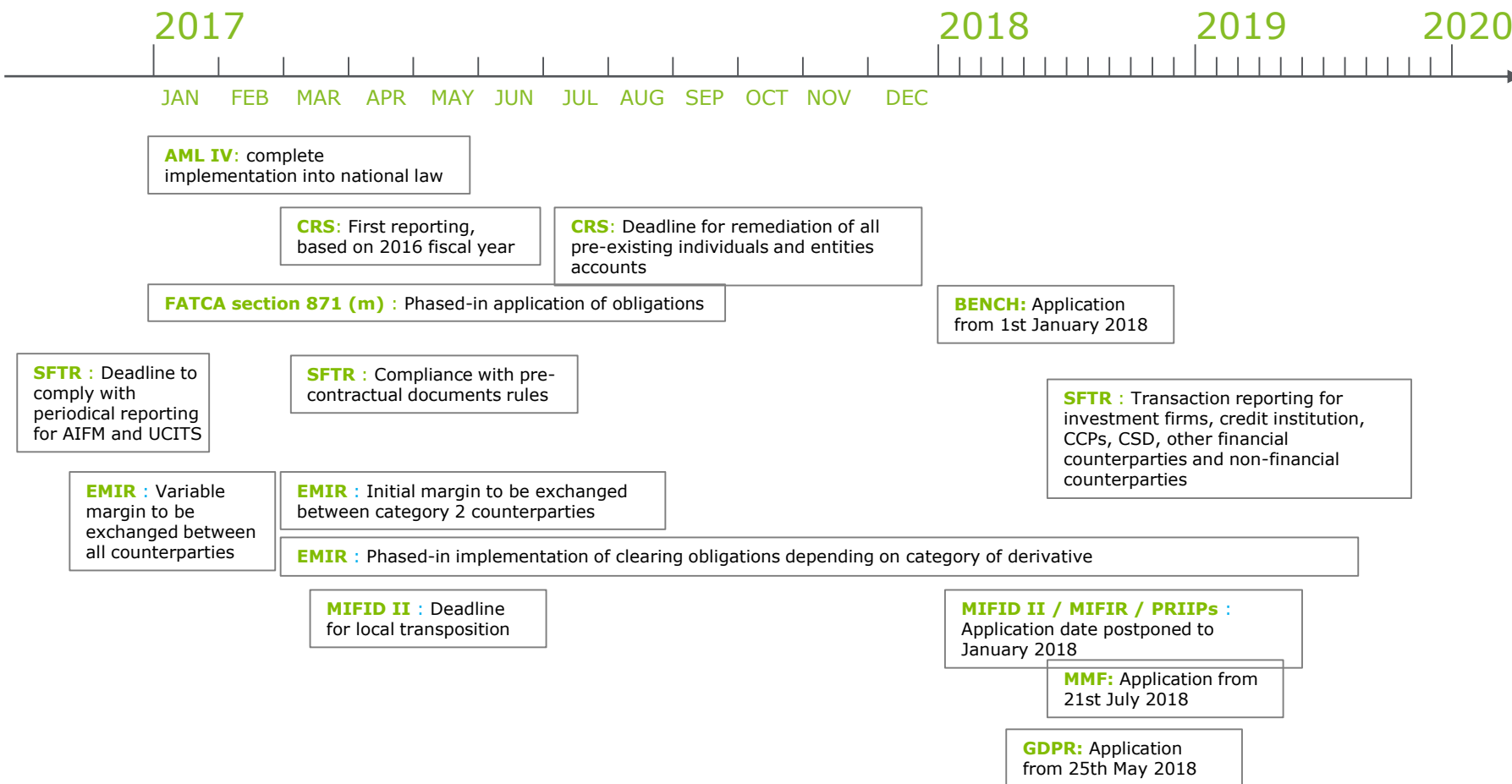
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## Agenda

- 01 Introduction
- 02 Brexit impact for IM
- 03 Recent ESMA opinion on delegation & substance
- 04 EU draft regulation on ESA powers

# Regulatory hot topics to keep under the radar



**AML IV:** Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing

**BENCH:** Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds

**CRS:** Common Reporting Standards; OECD 2014

**EMIR:** Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure)

**FATCA:** Foreign Account Tax Compliance Act; US federal law 2010

**GDPR:** Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data (General Data Protection)

**MIFID II / MiFIR:** Directive (EU) 2014/65 on markets in financial instruments and Regulation (EU) 600/2014

**MMF:** Regulation (EU) 2017/1131 on money market funds

**PRIIPs:** Regulation (EU) 1286/2014 on Packaged Retail and Insurance-Based Investment Products

**SFTR:** Regulation (EU) 2015/2365 on transparency of securities financing transactions

# Brexit

# Overview of Impacts

## The issue of 'passporting' and equivalence- Financial Regulations

### 'Passporting' in the EU

- Principle: firms authorised in one member state can carry out their activities in any other EU/ EEA country.
- Products authorized in one member state can be distributed in any other EU/EEA country.
- Firms can 'passport' in two ways:
  - establishing a branch/agent; and
  - free provision of services

### Financial Directives & Regulations that underpin UK access to the EU Single Market

- Undertakings for Collective Investment in Transferable Securities (UCITS)
- Alternative Investment Fund Managers Directive (AIFMD)
- Markets in Financial Instruments Directive/Regulations (MiFID/MiFIR)
- European Market Infrastructure Regulations (EMIR)
- Capital Requirements Directive/Regulation (CRD/CRR)
- Solvency II Directive
- Insurance Mediation Directive (IMD)
- Payment Services Directive (PSD)
- Second Electronic Money Directive
- Market Abuse (MAD/MAR)

### Consequences of firms losing the right to passport in the EU?

- UK firms may need to:
  - Build a presence in the EU/EEA in order to continue carrying out activities across the EU
  - Obtain authorisation from competent local authorities.
  - Comply with both UK and host country regulation.
- EU firms may need to be authorised by UK authorities in order to access the UK market.
- Cross-border groups may need to restructure.

### Could the right to sell cross border be potentially maintained for UK firms?

- EEA membership.
- Single market access in bilateral agreements.
- Equivalence if the UK becomes a "third country":
  - May enable UK firms to continue offering certain services and products into EU Member States based on the "passport"
  - Not currently available for all products and activities

# Overview of Impacts

## Other impacted areas– Non-Industry and Tax

Non-Industry Regulation	Current Added value
<b>Data Protection</b>	<ul style="list-style-type: none"> <li>• Development of rules on control over personal data and data protection, simplification of rules for companies in the Digital Single Market</li> </ul>
<b>AML/KYC</b>	<ul style="list-style-type: none"> <li>• Expanded scope of persons and activities subject to the AMLD IV, enhanced transparency with regard to beneficial owners</li> <li>• Development and reshaping of risk based approach</li> </ul>
<b>EU Company Law (mergers &amp; divisions, cross-border business operations, EU legal Entity)</b>	<ul style="list-style-type: none"> <li>• Benefiting from general rules on setting up limited liability companies, capital and disclosure requirements, framework for setting up single member company</li> </ul>
<b>EU Labour Law (Employment, Social affairs &amp; Inclusion)</b>	<ul style="list-style-type: none"> <li>• Harmonization of minimum standards for living and working conditions and informing and consulting workers about their situation</li> </ul>
<b>Bankruptcy Law</b>	<ul style="list-style-type: none"> <li>• Impact on each type of contracts governed by the UK law including ISDA, GMRA, GMSLA, etc.</li> <li>• Impact on the UK court proceedings</li> <li>• No material rule harmonized within the EU</li> </ul>
<b>VAT</b>	<ul style="list-style-type: none"> <li>• Common set of rules (including territoriality)</li> <li>• Harmonized VAT rates and scope of application</li> </ul>
<b>Double Tax Treaties</b>	<ul style="list-style-type: none"> <li>• No withholding tax on dividend payments, no taxation on dividends received</li> <li>• No withholding tax on interest and royalties</li> <li>• Tax free cross border mergers</li> <li>• Exchange of information (and rulings) including Common reporting Standards and Country-by-country reporting</li> <li>• Anti-Tax Avoidance Directive</li> </ul>
<b>Capital Duty &amp; Customs Duty</b>	<ul style="list-style-type: none"> <li>• The Capital Duties Directive prevents member states from imposing tax on the raising of capital by companies, such as share issues.</li> <li>• No custom duties within the EU</li> </ul>
<b>Treaty on the Functioning of the European Union</b>	<ul style="list-style-type: none"> <li>• Tax impacts of the freedom to provide services and of establishment</li> <li>• Prohibition of certain State aids (including fiscal State aids)</li> </ul>

# Brexit & Market Access

## Options for impacted actors ?

	Impact	Options for impacted actors
<b>UK Funds</b>	<ul style="list-style-type: none"> <li>UK fund no longer benefits from EU marketing passport</li> <li>UK fund may no longer be served directly by EU Management Company</li> </ul>	<ul style="list-style-type: none"> <li>Create a EU mirror fund / merge with existing EU fund / re-domicile fund / transform UK fund into a feeder of EU master fund / co-management set ups</li> </ul>
<b>UK Management Companies (ManCo)</b>	<ul style="list-style-type: none"> <li>UK ManCo may no longer manage / and market directly EU UCITS or EU AIF</li> <li>UK ManCo may no longer be able to operate under a EU branch</li> </ul>	<ul style="list-style-type: none"> <li>Appoint a EU ManCo / or acquire a EU Manco &amp; act as delegated portfolio manager</li> <li>Transfer Business and resources to another group EU ManCo</li> <li>Re-domicile ManCo</li> <li>Transform EU branch into a subsidiary</li> <li>Organize dedicated sales forces out from the EU</li> </ul>
<b>UK Portfolio Managers/Advisers</b>	<ul style="list-style-type: none"> <li>UK Managers no longer able to manage or advise individual clients on a cross border basis - except reverse solicitation-</li> <li>UK Managers no longer able to operate under a EU branch</li> </ul>	<ul style="list-style-type: none"> <li>Consolidate existing ManCo activities with Mifid activities in the EU</li> <li>Acquire a MiFID entity</li> <li>Transform branch into subsidiary</li> </ul>
<b>UK Distributors</b>	<ul style="list-style-type: none"> <li>UK Distributor may no longer be the regional center for cross border distribution of funds in the EU</li> <li>UK Distributor may no longer operate through EU branches</li> </ul>	<ul style="list-style-type: none"> <li>Transfer the business to another EU group entity (Mifid firm or ManCo)</li> <li>Transform branches into local subsidiaries</li> <li>Create new entity in the EU or partner with an existing</li> </ul>
<b>EU Management Companies / EU Funds</b>	<ul style="list-style-type: none"> <li>ManCo and Distributor may no longer operate through permanent establishment in the UK</li> <li>EU funds may no longer be passported in the UK</li> </ul>	<ul style="list-style-type: none"> <li>Acquire EU business</li> <li>Reallocate operations in another UK based group entity / partner with local fund operators / acquire</li> <li>Seek authorisation for the product in the UK / relocate or replicate fund in the UK for UK investors / UK feeder fund of EU master</li> </ul>



# ESMA supervision

# ESMA Opinion to support supervisory convergence in the area of investment management

## Not legally binding but...

On 13 July 2017, the European Securities and Markets Authority (ESMA) has published **an Opinion setting out sector-specific principles in the area of investment management**, aimed at fostering consistency in authorization, supervision and enforcement related to the relocation of entities, activities and functions from the United Kingdom.

The intention of the Opinion is to ensure that the choice of a new location in the Brexit context is directed by actual business needs and to provide further clarification when it comes to prerogatives of home Member State NCA which shall retain the grip and control of critical operations of the relocating entities.

This should be achieved through compliance with general principles set out in the Opinion which could be divided into 3 topics of highest concern: authorization requirements, governance and delegation arrangements.

This presentation summarizes mentioned crucial points of the ESMA Opinion which Deloitte considers most relevant to the IM industry, their possible impact on NCAs practice going forward and the amount of additional compliance effort that it may require from actors established in Luxembourg.

The Opinion, although more particularly directed at Asset Managers considering to relocate in the EU following to Brexit, is likely to have impacts **on all actors established in the EU**.

As a result of this **ESMA Opinion**, **NCAs** may decide to **reinforce existing requirements or create new obligations**.

Note that this document is for information sharing purposes only and does not amount to an advice or anticipation of CSSF possible developing practice as a result of the Opinion.

# The main areas of impact are fourfold

## ... more precise documentation and justification

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### Substance

- ESMA proposes to align UCITS substance requirements to AIFM concept i.e. portfolio and risk management
- ESMA provides with minimum substance in the Manco (3 FTEa) as well as some key criterias to apply to ensure substance is in line with size, nature, scale and complexity of the business
- ESMA re-inforces the paramount role of local authorized management ensuring the ultimate decision-making is local

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### Governance

- ESMA outlines that sound governance and internal control mechanisms require clarity as to the allocation of responsibilities, documented policies and procedures, structures
- ESMA insists NCAs to assess and put additional scrutiny on individuals with high numbers of (executive or non-executive) directorships
- ESMA highlights the importance of the senior management of the entity being available locally

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### Delegation

- There must be documented objective reasons for delegation of any type of activity (incl. function such as IT, Legal, Finance, etc.): (i) detailed descriptions, (ii) explanations and (iii) evidence of the objective reasons provided
- Delegation to non-EU entities (directly or via chain of delegation) could make oversight and supervision of the delegated functions more difficult
- Delegation process and oversight are to be well documented and objectively reviewed (initial due diligence via RFP, on-going due diligence with a focus on on-site visits)
- Authorized entities should demonstrate to NCAs that they dedicate sufficient human and technical resources to initial and on-going due diligence process i.e it is unlikely that a single person has sufficient knowledge, experience and time to monitor a broader range of complex functions

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### Internal control function

- ESMA is highlighting that compliance, internal audit and risk management function must take active part to strategic decisions.
- ESMA is putting emphasis on the necessity for the internal control functions, to ensure compliance does actually happen, including through escalation process to the regulator in last instance.
- Internal control functions must carry out desk-based and on-site controls on an ongoing basis and are involved in the client acceptance and fund set-up processes (often organized in internal committees). These substantial activities usually necessitate a local presence.

# EU Commission Draft Regulation on new organization and powers of European Supervisory Authorities

## ESAs will have pivotal role in certain sectors

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### Shift of supervisory powers from NCA to ESMA

According to the proposal, ESMA would become the **direct and exclusive supervisor over certain sectors** across the EU. The new tasks would concern:

- **Approval and supervision of certain Prospectuses** governed by the EU Prospectus Regulation;
  - **Approval and supervision of certain EU labelled investment funds** (European Venture Capital Funds, European Social Entrepreneurship Funds and European Long-Term Investment Funds);
  - **Authorization and supervision of EU's critical benchmarks** as well as endorse non-EU benchmarks for use in the EU; and
  - **Coordinating** market abuse investigations, notably through direct intervention or coordination of cross-border investigations.
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### Second level review of cross border delegation arrangements with third countries

While initial notification and authorization remain with the home country NCA, the latter will then have to notify semi-annually the ESAs (ESMA and EBA) of all outsourcing setups approved by them during the period and ESMA will review these set ups.

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### New activities for ESAs in sustainable finance and FinTech

In a forward-looking perspective, ESAs will also be tasked with promoting **sustainable finance**. ESAs should account for environmental, social, governance-related factors, and risks. Priority should be given to monitoring and supporting **FinTech and cybersecurity developments**.

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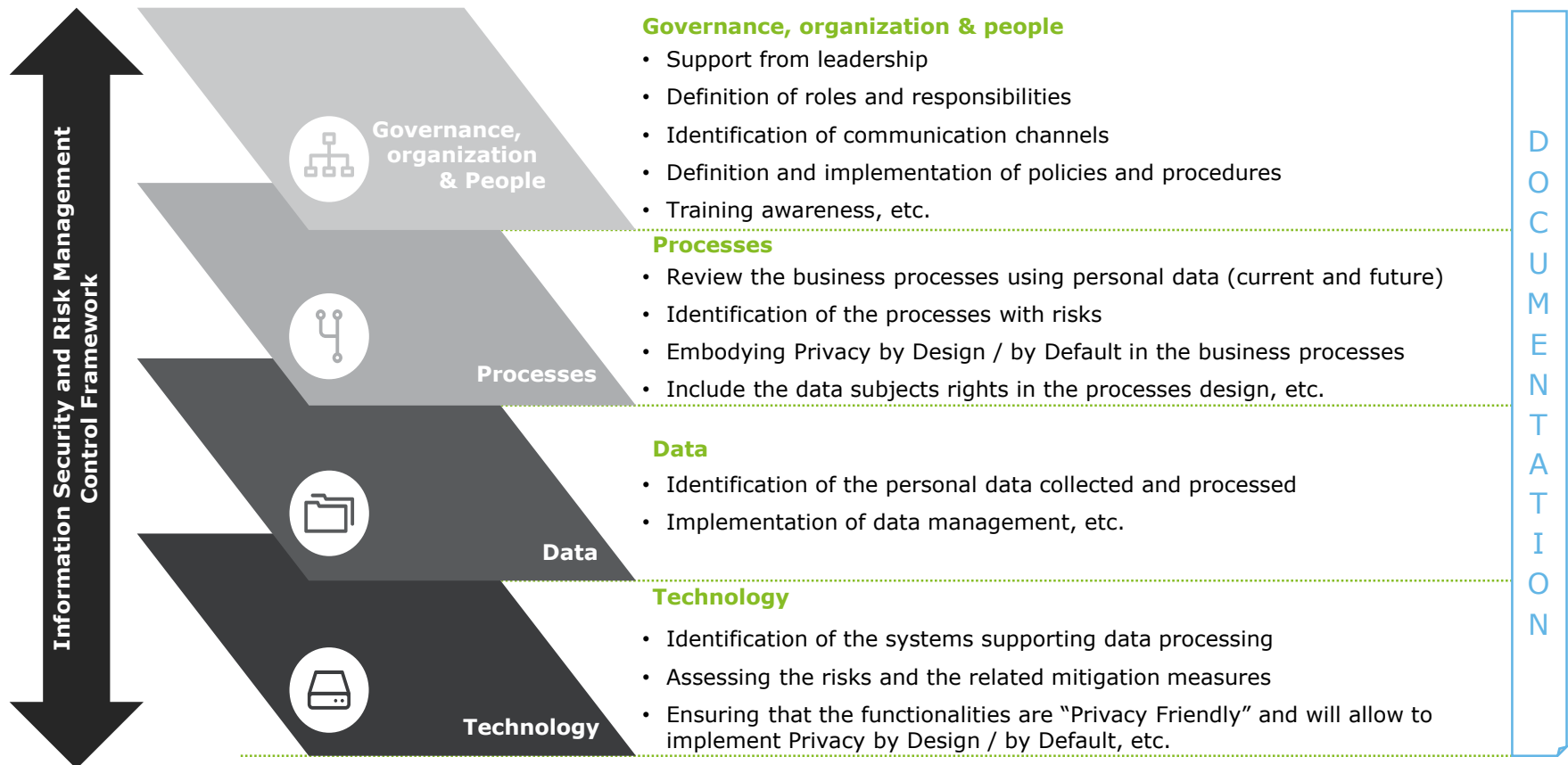
### Next steps and approval process

**Now that the proposal is out, the regulatory process will kick in.** The EU Parliament and EU Council (MS) will have to define their preferred version of the proposal. **In this process, subject to the usual uncertainties about the attitude** of EU Council and the EU Parliament, the systemic and political implications will for sure overwhelmed any debate. Based on experience, the regulatory process should be finalized before somewhere in 1Q19 with application probably at the end of the year.

# General Data Protection Regulation (GDPR)

# Impacts on the operating model

GDPR will mainly impact four layers of the operating model



# Impacts on the operating model

## Examples of how GDPR will impact organizations



### Governance, organization & people

- The right of data subjects to information which is specific and quite extensive will need adaptations to the terms and conditions.
- The accountability of data controllers means having the right kind of subcontracting in place. Transfers of personal data outside of the EU need further guarantees

### Processes

- Extended rights, specifically the consent will force a review of websites in order to ensure that consent is collected correctly for cookies.
- Backup procedures need to be reviewed.
- DPIAs must be conducted for processing linked to MAR, Mifid, Fatca, ... for employees and clients to validate their proportionality and necessity.

### Data

- The need to better manage data retention will need a better understanding of where data is stored.
- The discovery of a data breach will need procedures to notify the local DPA within 72h.

### Technology

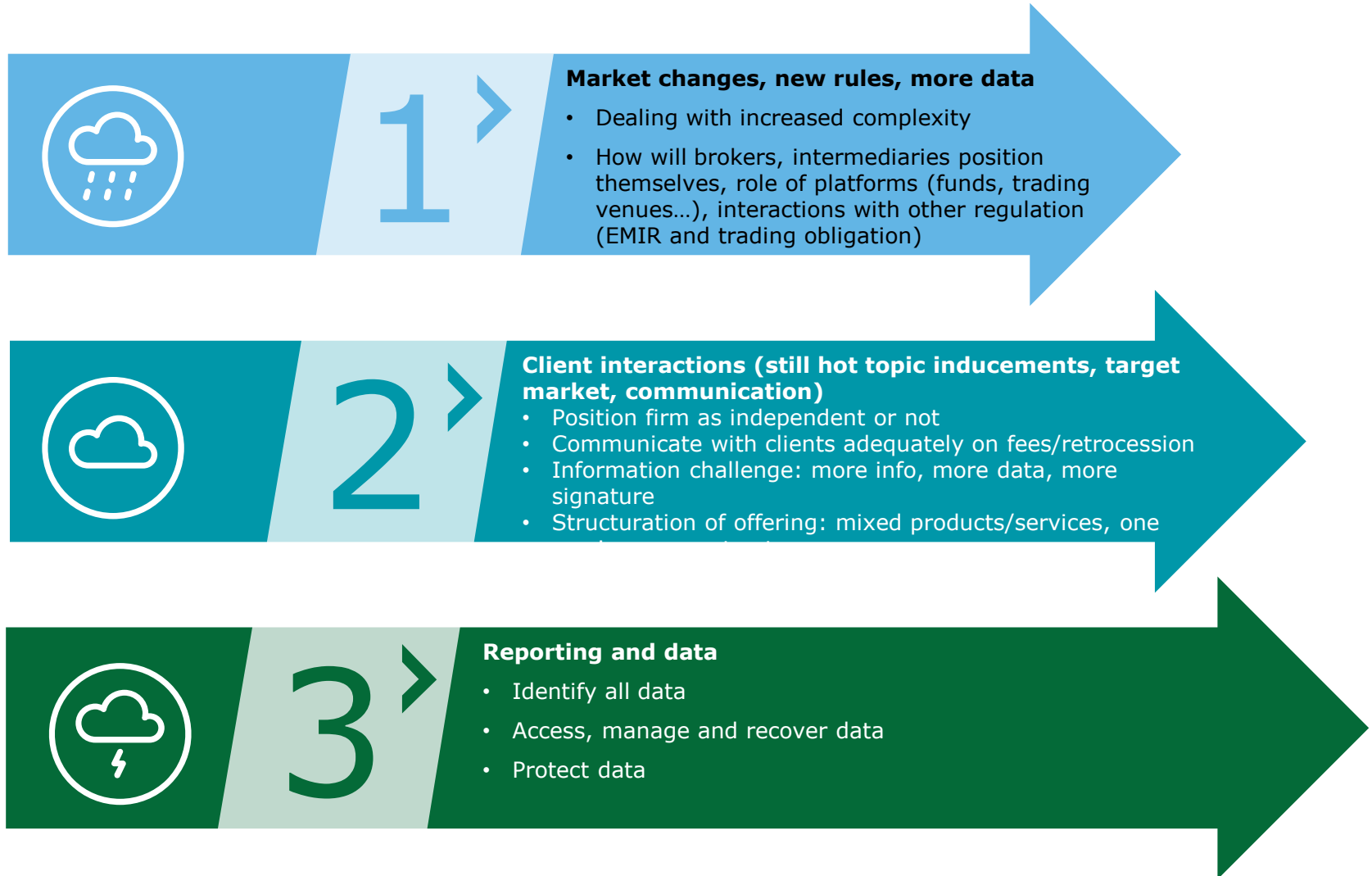
- Retention and the need to delete data for which no legitimate purpose exists anymore will need technical modifications.
- Digitalization like remotely entering into a relationship with a customer will need documented data protection by design approaches

# MiFID



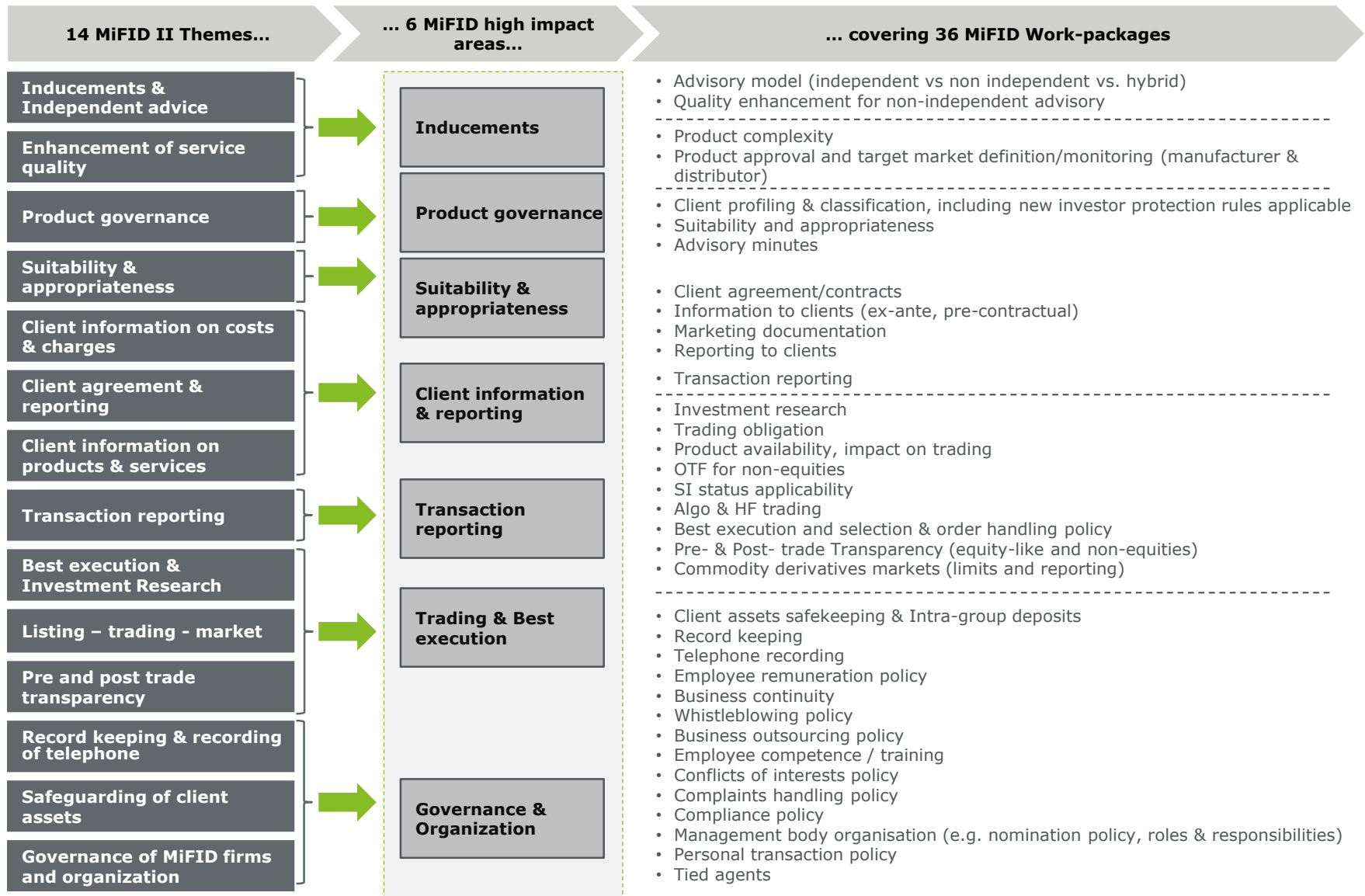
# MIFID II – MIFIR heading to the start line

## 3 sets of challenges



# Managing project through different Work-packages

- Client Stream
- Market Stream
- Governance Stream



# MiFID

## Latest challenges

- ➔ ESMA publications of Q&A
- ➔ Availability of software providers
- ➔ Lack of data to determine SI status
- ➔ Uncertainties about market (MIFIR) statistics once UK is out, heading for a review?
- ➔ New topic: training and qualification
- ➔ Application of MIFID to non-MIFID entities (i.e. Manco, asset managers, research providers...)
- ➔ Consolidation of data (for reporting)
- ➔ MIFID then what, the trilogy
- ➔ **Completion of regulatory phase**
- ➔ **Emergence of digital**
- ➔ **Dealing with Brexit**



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