

# Relocating financial services operations due to Brexit?

What you need to know about the EU's strict *"Supervisory Principles on Relocations"*

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# Sharpened scrutiny in the supervisory principles on relocations (the SPoRs)

## Clear expectations from the European Supervisory Authorities and the European Central Bank

The regulatory and financial concerns arising from BREXIT prompted the various European Supervisory Authorities (ESAs) as well as the European Central Bank (ECB), acting in its Banking Union supervisory role in the Single Supervisory Mechanism (SSM) to issue a series of communications and Opinions during 2017 setting out their “supervisory principles on relocations.” A number of these SPoRs were updated during 2018.

The ESAs and the ECB-SSM published these updates and further refinements to the SPoRs following their concerns that:

1. the applications that were received up to the first quarter of 2018 were either insufficiently detailed and/or some were inadequately reflective of how the application reflect the relevant SPoRs; or
2. the volume of applications received prior to the “official” June 30, 2018 application cut-off date were, when compared to the body of potential BREXIT-impacted entities, relatively limited.

The EU supervisory policymakers have repeatedly pointed out that despite the political confusion on what “Brexit means Brexit” actually means they would not excuse a “wait and see” approach and poor planning in relation to Brexit-proofing legal entity operations and/or contractual continuity.

## The problem: Third country status post-Brexit

Once the UK leaves, it will become what the EU terms a “third country.” Firms based in the UK will, regardless of the political post-Brexit models, lose automatic rights to “passport” their services or establish branches on a cross-border basis. Existing passports are expected to become invalid. Market participants affected by these changes will want to act individually to safeguard their interests and those of their clients but equally will need to coordinate amongst peers, including on legal entity structuring but also on documentation. This may also apply where certain industry/trade associations have only started to consider how to Brexit-proof documentation suites.

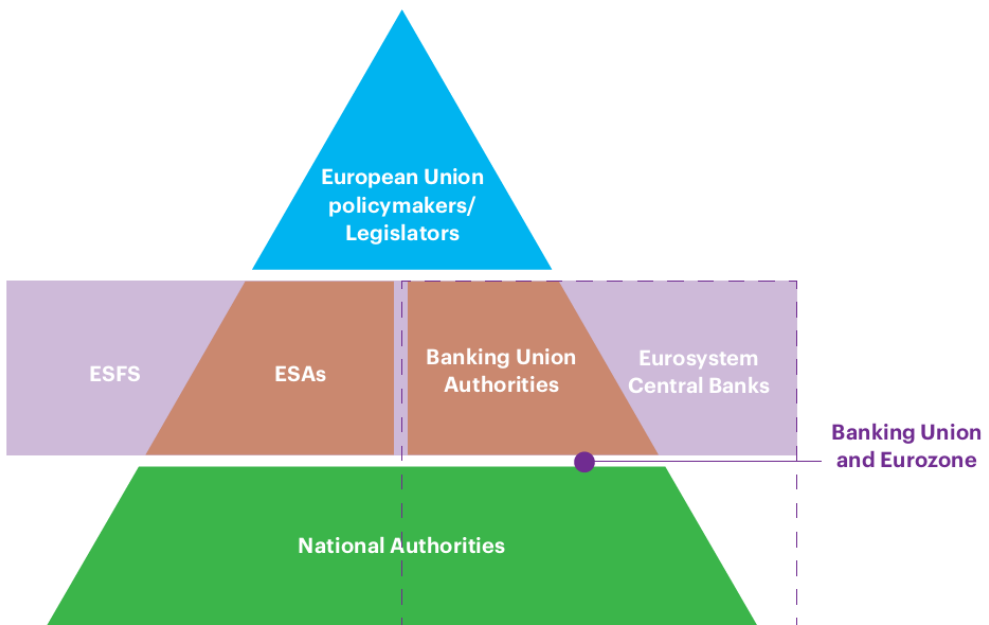
For those that had begun to design and implement contingency planning and Brexit-driven license applications, the detail in the 2017 SPoRs, as sharpened by the “2018 Updates”, have caused, or should cause, many, irrespective of whether having received institution-tailored supervisory notifications, to re-examine plans. This also applies to those setting-up regardless of Brexit or based in the EU-27 that are looking the other way and expanding operations in the UK.

In many ways the SPoRs introduced some firm lines and also reaffirmed the position of the ESAs, the ECB-SSM and the national competent authorities (NCAs) to whom most of the SPoRs address action points in how they resource and approach their own supervisory mandates where they and not the ESAs or ECB-SSM are in the lead. The overarching tone is clear that the EU will not tolerate a “regulatory race to the bottom,” the use of “empty shell companies” or behavior that is more “cute than compliant”.

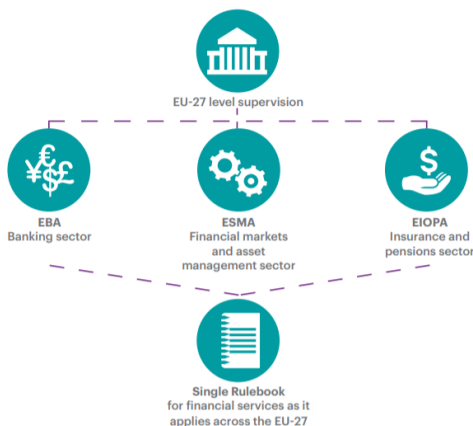
# The new Super-Supervisors

Banking Union, Capital Markets Union, BREXIT and Eurosystem monetary policy are all changing the way business is structured, booked, executed, custodied, reported, provisioned and supervised across the EU-27 and the Eurozone-19. The Single Market for financial services in the EU is increasingly made up of a “Single Rulebook” of EU legislative instruments based on an increasingly “Single Supervisory Culture”. In addition to new requirements, the dynamic of rulemaking and also who sets the tone of supervisory engagement across the EU’s Single Market for financial services is being driven increasingly at the EU and Eurozone level rather than by national authorities (NCAs).

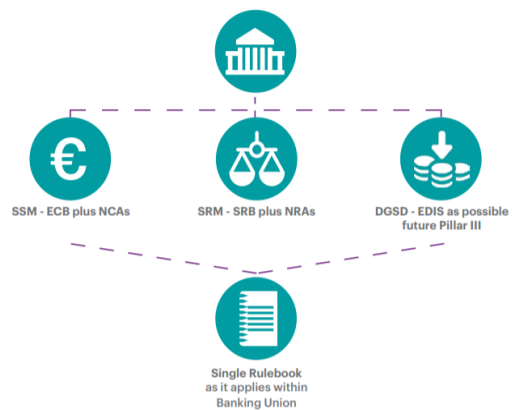
This “Europeanisation” of financial services rulemaking is a direct result of the 2007 financial crisis. In the Eurozone and its Banking Union the application of the Single Rulebook and the Single Supervisory Culture is streamlined even further by the “Single Supervisory Mechanism” and “Single Resolution Mechanism” as institutional “pillars” of the Banking Union.



## ESAs – European Supervisory Authorities



## Banking Union Regulatory and Supervisory Bodies



# A spotlight on the SPoRs of EBA, ESMA, EIOPA and ECB-SSM

## Core principles

Despite each of the ESAs and the ECB-SSM having tailored the SPoRs to the specifics of the components of the market that they supervise, they are all built on the following core principles:

1. No automatic recognition of existing authorizations;
2. Authorizations granted by EU-27 NCAs should be rigorous and efficient;
3. NCAs should be able to verify the objective reasons for relocation;
4. Special attention should be granted to avoid letter-box entities in the EU-27 and unjustifiable booking of business/risk to third-countries;
5. Outsourcing and delegation to third-countries is only possible under strict conditions;
6. NCAs should ensure that substance requirements are met in terms of people, processes and risk origination and its management;
7. NCAs should ensure sound governance of EU entities;
8. NCAs must be in a position to supervise and enforce EU law effectively; and
9. NCAs need to implement coordination to ensure effective monitoring.

## Affected firms will need to:

- Review existing and pending BREXIT-proofing and relocation plans and take remedial action if necessary;
- Critically assess certain structuring decisions and assumptions, notably in relation to outsourcing, booking models as well as risk models and regulatory capital levels; and
- Allocate sufficient time and resources in order to take account of potentially more protracted and more invasive supervisory touchpoints along each of the levels of supervisory engagement.

## Where each of the “Super-Supervisors” focus their own scrutiny

- **The European Banking Authority’s (EBA) SPoRs** – See our *dedicated Client Alert* [here](#)

The EBA’s SPoRs apply to credit institutions and the banking sector, MiFID Investment Firms and the investment management sector (but not regulated funds and their managers), payment institutions and electronic money institutions engaged in payments-related business and credit intermediaries and specialist mortgage lenders. They include a range of details that are more granular than those of their peers.

- **The European Securities and Markets Authority’s (ESMA) SPoRs** – See our *dedicated Client Alert* [here](#) and on *SSOs* [here](#)

ESMA’s SPoRs are set out in a “General Opinion” which applies to all firms within its supervisory mandate, as supplemented by three standalone “Sector Specific Opinions” (SSOs) applicable to investment firms, asset management firms and financial market infrastructure providers. Both the SSOs and the General Opinion’s SPoRs were supplemented by a “2018 Update,” which added additional compliance expectations

- **The European Insurance and Occupational Pensions Authority’s (EIOPA) SPoRs** – See our *dedicated Client Alert* [here](#)

EIOPA, the smaller of three ESAs, but with responsibility for the insurance and pensions sector and thus potentially the larger transmission channel of risk from wholesale markets to real economy impact, specifically looks at where risks are originated/booked.

- **The ECB-SSM’s SPoRs** – See our *dedicated Client Alert* [here](#)

The ECB’s own SPoRs sharpen the focus on substance as it relates to governance and where risk is booked and managed – having also distinguished itself from its peers by looking at “off-shore and on-shore” capabilities instead of branches and subsidiaries. This along with other concurrent ECB-SSM work streams points to a potential widening of supervisory remit. Compliance with the SPoRs forms part of the on-going supervisory dialogue with existing and new Banking Union Supervised Institutions.

# Outlook and steps to consider for firms

## A focus on policies and procedures

The impending challenges of Brexit add complexity to a range of decisions related to relocations, BREXIT-proofing of legal entity structures as well as counterparty and client-facing documentation. Compliance with the SPoRs is important in all those stages but it is certainly paramount when it comes to drafting or amending policies and procedures that the new or expanded Brexit-proofed entities are expected to submit in support of license applications and to embed upon regulatory approval.

Policies and procedures are not only important because they hang the “meat on the supervisory skeleton” of an organization, but they are also an evidence of how a risk-based compliance and control function culture is embedded throughout the organization. More importantly they are the roadmap to the strategic steering of a firm and its business as usual i.e. “run the business” operations but also in relation to the “build the business” and/or “change the business” as well as “change the compliance” work streams.

As a result, whilst offering a manual to how a firm functions and its culture, policies and procedures are an easy place to start for supervisors when assessing the effectiveness of design and operation of the policies and procedures as well as the degree of compliance.

## More rulemaking and scrutiny ahead



More harmonisation and streamlining of rules and practices, within the EU-27 as a result of CMU and also more joined-up workstreams, such as consumer protection is expected. Within the Banking Union the ECB-SSM will continue to set an accelerated tone on supervisory convergence using tools to eliminate national options and discretions or fill gaps in the Single Rulebook.



Expectation that ECB-SSM will continue “rolling out” rules that apply to ECB-SSM direct supervised “Significant Credit Institutions” to those NCA-SSM direct supervised “Less Significant Institutions”. This is coupled with an expectation that NCAs, including non-Eurozone, will increasingly “mirror” the practice of the SSM. Separate to this there is also a drive for a more proportional regime for smaller credit institutions yet key will be in demonstrating sufficient evidence of suitable compliance.

## We’re here to help!

Our team of dedicated financial regulation and disputes specialists can help you in reviewing how your BREXIT-proofing work streams meet and evidence SPoR compliance as well as other expectations of the ECB-SSM.

Our **Eurozone Hub** has particular expertise in conducting Brexit red-flag risk reviews on business and distribution models as well as considerations that are specific to complex structured finance transactions. We are also regularly engaged to assist various market participants in setting up new or optimizing existing legal entity structures, drafting or amending contractual documentation and internal policies and procedures so that their business complies with EU, UK, US and global supervisory expectations.

We can also advise, together with our Litigation & Dispute Resolution team, during contracting on the right choice for you in Brexit-proofing contractual arrangements with counterparties and suppliers as well as amending client-facing documentation to remain fit for purpose and meet supervisory expectations.

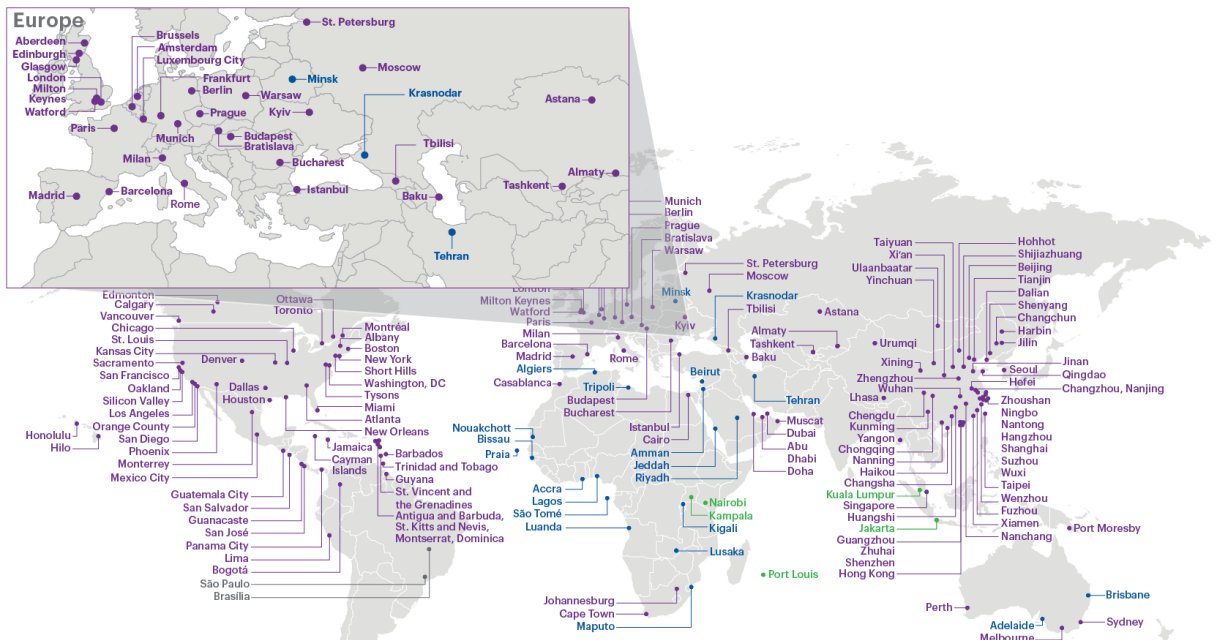
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Our Eurozone Hub can deliver value to you by solving regulatory issues and using regulation to your advantage.

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# We look forward to continuing the conversation!

In addition to Client Alerts, Background Briefings and other updates from our Eurozone Hub, our wider Eurozone group lawyers regularly publish in various journals to contribute or lead on advancing the debate amongst practitioners and stakeholders on the future evolution of the Banking Union, Capital Markets Union and monetary policy activity. To receive the latest updates, details on forthcoming public events, private roundtables or to join us in the conversation shaping the future of financial services, please do speak to any of our Eurozone Hub contacts.

## Our Eurozone Hub

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