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Insights

ESMA REMINDS UK INVESTMENT MARKET OF THE MIFID II REVERSE SOLICITATION RULES

14 January 2021

ESMA has issued a stark reminder that reverse solicitation, where it can be used, has to be carefully managed and documented, and is an area of regulatory scrutiny and focus. This short note also takes stock on the EU27 market access impact of full-scope UK AIFMs that become non-EEA AIFMs on Brexit.

The UK withdrew from the EU and the EEA on 31 January 2020. Following its withdrawal, the UK entered a transition period until 31 December 2020, during which EU law continued to apply in the UK. On 24 December 2020 the UK and the EU announced they had agreed a UK-EU Trade and Cooperation Agreement (the **TCA**) to apply in principle from 1 January 2021, prior to being ratified in the UK and EU Parliaments. The financial services provisions of the TCA are very limited: there are no equivalence decisions and, as anticipated, neither does the TCA include any rights for UK firms to passport their services into the EU from 1 January 2021. Further, UK investment firms cannot benefit from temporary access arrangements to the EU27 markets akin to the FCA's Temporary Permissions Regime.

Reverse solicitation under MiFID

For UK investment firms that provide services under the MiFID II Directive, reverse solicitation remains a possibility. This is when a client established within the EU initiates "at its own exclusive initiative" the provision by a third country firm of investment services or activities. It allows a firm to service EU clients without triggering local licensing requirements. The third country firm cannot then market new categories or investment products or services to that client (as that would no longer be reverse solicitation).

On 13 January 2020 ESMA issued a public statement on the MiFID II rules on reverse solicitation. ESMA reminds the market of three principles:

- First, that clients or potential clients can be solicited by all means of communications - phone calls and meetings as well as press releases, internet advertising and brochures. ESMA also flags questionable practices being employed to evidence that the transaction is at the investor's own initiative, such as box-ticking in client terms of business.

- Secondly, that any solicitation, promotion or advertising in the EU can be made by any person acting on behalf of the investment firm, however casual it may appear.
- Thirdly, ESMA also reminds the market of the consequences of those providing or using services without proper authorisations (namely, the risk of administrative or criminal proceedings for service providers and loss of regulatory protection for investors).

This public statement by ESMA is a clear warning sign to firms who are conducting business into the EU in purported reliance on the reverse solicitation exemption from licensing under MiFID. Such firms need to look very closely at the manner in which they are conducting their activities to ensure that they truly amount to reverse solicitation in the narrowly defined ESMA sense. Interestingly, some EU jurisdictions may have taken a more permissive view on reserve solicitation in the run up to Brexit that is not entirely consistent with ESMA's stance. Over time these jurisdictions may well need to realign their approach to ensure supervisory convergence across the EU with ESMA's position. Reverse solicitation is not the only licensing related concept that may be subject to a degree of regulatory elasticity over time. Firm's need to mindful that the precise boundaries around licensing rules and principles (including those relating to reverse solicitation) are very likely to continue to evolve in the post-Brexit regulatory environment. This may, in turn, require some firms to rethink their post-Brexit compliance strategy for doing business into the EU from outside it.

Reverse solicitation under AIFMD

Reverse solicitation is also found in AIFMD. However, it is not considered a viable option where there is 'pre-marketing' under AIFMD (from August 2021 the EU Cross-Border Distribution legislation introduces a new concept of and provisions on 'pre-marketing').

Article 42 NPPR under AIFMD

For the purposes of AIFMD, from 1 January 2021 UK AIFMs are 'third country firms' who are unable to use the AIFMD marketing passport. Pending (and subject to) the adoption and extension of the third country passport to the UK, UK AIFMs marketing AIFs in the EU can now only access investors in each of the EU27 member states pursuant to the Article 42 National Private Placement Regimes (**NPPRs**). One of the external preconditions has been met, that of a regulatory co-operation agreement to cover supervisory co-operation, information exchange and enforcement: the multilateral Memoradum of Understanding between the FCA, ESMA and the EEA regulatory authorities was agreed in February 2019 and came into effect on 1 January 2021. Alongside other conditions, the AIFM is subject to the AIFMD rules relating to disclosing information to investors in advance of their subscription; preparing and providing an annual report to investors; and reporting to the EU27 regulators, as relevant.

In addition to the threshold conditions that AIFMD imposes on AIFMs who have to rely on NPPRs to access investors in the EU27, individual member states can (and some have) imposed additional requirements on AIFMs and in certain jurisdictions an NPPR has not been made available.

Marketing using NPPRs is therefore piecemeal, and can be time-consuming and costly, whereby managers need to apply on a country-by-country basis for permission to market individual funds.

Please do not hesitate to get in touch with any of the authors or your usual BCLP contact if you would like to discuss any of the issues raised in this briefing in more detail, including how they may apply to your specific fund and advisory structures, cross-border activities, business and planning.

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Matthew Baker

Co-Author, London

matthew.baker@bclplaw.com
+44 (0) 20 3400 4902