RegCORE Client Alert

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On 2 February 2022, the European Securities and Markets Authority (**ESMA**) published a supervisory briefing[1] regarding its expectations in relation to investment firms use of tied agents within the MiFID II[2] framework. One of ESMA's objectives is to actively foster and strengthen the supervisory convergence across the Union "…with the aim of creating a common supervisory culture". This is relevant as it sets a common understanding for national competent authorities (**NCA**s) of EU Member States to consider in their own supervision of financial services firms. MiFID II required EU Member States to implement the tied agent regime in full whereas under MiFID I it was optional thus leading to divergences.

Following the UK's withdrawal from the European Union, ESMA has been monitoring the behaviour of financial services firms in order to understand whether their interaction with EU-based clients is done in a way that is compliant with MiFIR[3] and MiFID II. In this context, some practices concerning investment firms and their use of tied agents recently emerged as a potential source of circumvention of the abovementioned legal framework.

ESMA's supervisory briefing focuses on the regulatory expectations in relation to investment firms using tied agents:

- when appointing tied agents; and
- on an ongoing basis.

[1] Details of which are available here.
[2] 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, as amended.
[3] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

Background

A tied agent is, according to Art. 4 (29) MIFID II, a natural or legal person who acts with full responsibility on behalf of a firm and solicits from clients regulated activities in relation to any financial instruments and performs full services in relation thereto. A company that appoints a tied agent remains unconditionally responsible for any act or omission of the tied agent when acting on behalf of that company.

Art. 29 MiFID II (3-5) sets out the legal requirements for investment firms when appointing tied agents, in particular:

- the tied agents shall be registered in the public register in the Member State where they are established (para. 3);
  - tied agents are only admitted to the public register if it has been established that it is of sufficiently good repute and that they possess the appropriate general, commercial and professional knowledge and competence so as to be able to deliver the investment service or ancillary service and to communicate accurately all relevant information regarding the proposed service to the client or potential client;
- investment firms appointing tied agents shall take adequate measures in order to avoid any negative impact that the activities of the tied agent not covered by the scope of MiFID II could have on the activities carried out by the tied agent on behalf of the investment firm (para. 4); and
- investment firms shall appoint only tied agents entered in the public registers (para. 5).

The MiFID II framework is fine-tuned by the MiFID II Delegated Regulation[4], which requires investment firms to ensure that their relevant persons, which include the tied agent according to Art. 21 (1)b MiFID II Delegated Regulation, are aware of the procedures which must be followed for the proper discharge of their responsibilities. Further, Art. 47 (1)(e) MiFID II Delegated Regulation also requires investment firms to inform their clients when they are acting through a tied agent.

Key points

ESMA cements and clarifies the regulatory requirements and its supervisory expectations by providing specific items that an investment firm should consider when appointing a tied agent and then on an ongoing basis.

In summary, when appointing a tied agent, investment firms shall:

- conduct a suitability test of the tied agent;
- contractually ensure their control rights over the activities of the tied agent; and
- once the investment firm appoints a tied agent, it shall monitor its activities.

While a lot of this may already reflect (best) practice amongst many investment firms, the ESMA supervisory briefing provides further prescriptive detail. Such detail may also be of relevance for other types of regulated firms, including those active in other parts of financial markets other than those for which ESMA is responsible for.

Suitability Test (*when appointing a tied agent*)

Investment firms shall assess the suitability of the potential tied agent. For the purpose of this suitability test, the investment firms shall:

- assess the registration of the potential tied agent in the public register kept by the Member State in which the tied agent is established;
- verify whether the potential tied agent is of sufficient good repute and possesses the necessary knowledge and competence;
- include the tied agent in the assessment of the knowledge and competence of staff in accordance with the ESMA Guidelines for the assessment of knowledge and competence;[5]
- assess whether the potential tied agent:
  - has the ability, capacity, sufficient resources and appropriate organisational structure to support the performance of the relevant activities;
  - can grant the same level of protection to the clients as the investment firm would do;

[4] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

[5] ESMA's Guidelines for the assessment of knowledge and competence, available here.

- is able to ensure the compliance with the MiFID II framework (in this case, special attention should be paid to the organisational structure of the tied agent, the knowledge and reputation of its employees and the reporting mechanisms); and
- the place from which the employees of the tied agent or any natural persons whose services are at the disposal and under the control of the tied agent will provide activities on behalf of the firm, and how such employees or natural persons are monitored (ESMA sets a **red flag** if the potential tied agent has no sufficient substance in the EU or if a tied agent mainly relies on resources based outside the EU).

Contractual provision of control rights (*when appointing a tied agent*)

According to ESMA the investment firm should have instruction and termination rights, rights of information and right of inspections along with access to books and premises of the tied agent. These should also be set out in an agreement between the investment firm and the potential tied agent. ESMA expects that such an agreement also addresses at least the following aspects:

- registration details;
- list of natural persons which are involved in the provision of services and clarification where these persons will be established for the provision of such services;
- description of the activities which the tied agent will provide on behalf of the investment firm;
- prohibition for the tied agent to provide services as tied agent for any other investment firm;
- obligation for the tied agent:
  - to disclose that it is acting in capacity as a tied agent and to disclose the investment firm which it is representing;
  - to protect any confidential information;
- description of the monitoring mechanism of the investment firm (reporting obligations etc.); and
- indication that the auditors can access the data related to the activities carried out by the tied agent on behalf of the investment firm as well as to the business premises.

Monitoring (*ongoing basis*)

The governance arrangements adopted by the firm are expected to be appropriate to monitor the activities carried out by the tied agents and proportionate to the number of the appointed tied agents, their legal nature, as well as their organisational and ownership structure. In particular, the investment firm shall ensure that the independence of persons providing investment advice is guaranteed. ESMA also focuses on the company's remuneration policies, which shall counteract conflicts of interest. The compliance function is also to play a special role in supervision of the tied agents.

The investment firm shall implement in particular:

- adequate organisational arrangements to monitor the tied agent;
- appropriate reporting mechanisms (e.g. the investment firm shall require (i) information on the number of clients, type of products, (ii) proof that the tied agent disclosed the name of the firm which it is acting on behalf of);
- adequate mechanisms to assess the quality of the services provided by the tied agents;
- adequate mechanisms for the identification of conflicts of interest; and
- rights, according to which it is able to terminate the relationship with a tied agent where necessary, with immediate effect when this is in the interests of its clients, without detriment to the continuity and quality of its provision of activities to clients. After a termination, the investment firm should inform the NCA as well as their clients, including specifying whether the termination is due to matters having a serious regulatory impact or involving a breach of MiFID II.

Multiple tied agent relationships and third country issues

ESMA's also sets out its expectations on relationships where tied agents act for other entities r under the control of third country entities. Specifically, it states, at para. 25 that (our emphasis in bold):

> "ESMA considers that **firms should avoid appointing a tied agent which is a legal person and whose employees involved in the provision of the activities on behalf of the firm (e.g., sale staff) are also at the disposal or under the control of other entities, including third-country entities**. Such entities could exercise inappropriate influence over the way in which a tied agent carries out the activities on behalf of the firm or may prevent the firm from effectively monitoring the activities of their tied agent (e.g., cases in which the tied agent is a legal person and is owned or controlled or has close links with a third-country entity that is itself involved in activities concerning manufacturing or distribution of financial instruments). **This includes instances in which natural persons are involved in the provision of the activities carried out by a tied agent on behalf of**

> **a firm as a result of arrangements with another entity such as staff sharing agreements or secondment. ESMA believes that allowing a tied agent to carry out activities on behalf of a firm by mainly using the resources of another entity, especially a third-country entity, constitutes a serious impediment to the firm's compliance with Article 29(2) of MiFID II** specifically the duty of the firm to monitor the activities of its tied agents so as to ensure that they continue to comply with MiFID II when acting through tied agents. To this end, and also to ensure that the duty of exclusivity to which tied agents are bound (by virtue of Article 4(29) of MiFID II) is fulfilled, **it is expected that tied agents have sufficient substance in the EU and do not mainly rely on resources based outside of the EU in the provision of activities on behalf of the appointing firm**."

The rationale behind this paragraph is clear. It aims to prevent reliance on staff and services offered from outside of the EU for regulated services to be provided into the EU and is in keeping with ESMA's various supervisory principles on relocations (SPoRs – see separate coverage on this from PwC Legal's RegCORE) that were first conceived in the context of Brexit but since widened to apply to third country entities more generally. It also ties in with ESMA's supervisory expectations and restrictions on "back-branching" and/or double hatting – equally both areas that have come under scrutiny from ESMA and other EU-level authorities along with NCAs.

Outlook

While ESMA's supervisory briefing (at para. 8), certainly in its current form, states that the content provided therein is not binding, and thus that NCAs are not formally subject to a comply or explain approach this is counterbalanced by statements at para. 17 of the supervisory briefing, where ESMA states that:

> "The present supervisory briefing provides the common understanding of ESMA and NCAs with regard to the supervision of firms using tied agents to provide investment services and/or activities and aims at contributing to the development of a convergent supervisory culture across the [European] Union. It is also meant to give indications to market participants of compliant implementation of the MiFID II provisions relating to tied agents. ESMA acknowledges that, especially in some jurisdictions in which the use of tied agents is common, the relevant NCAs are expected to apply the supervisory briefing within a reasonable timeframe."

Equally at para. 18, ESMA provides NCAs with flexibility and a proportionate risk-based approach, in specifying:

> "The content of this supervisory briefing is not exhaustive, does not constitute new policy, and does not promote any particular way of supervising the rules. It has been designed to be used in the way that best fits with supervisors' methodologies (whether distributing the briefings internally, or passing them to external bodies, such as auditors, for example). NCAs may apply the supervisory expectations set out in this supervisory briefing in a manner that is proportionate to the size, risk profile, and nature, scale and complexity of the firms in question, its proposed tied agent(s) and its appointed tied agent(s)."

It remains to be seen how NCAs, in particular Germany's BaFin, will react to this briefing, especially whether it will adopt these requirements in its administrative practice and supervisory dialogue with firms Importantly, for those investment firms that operate in the Banking Union and which are subject to supervision by the European Central Bank (**ECB**), in its role at the head of the Single Supervisory Mechanism (**SSM**), it is expected that the ECB-SSM could well refer back to ESMA's supervisory outcomes as part of its own supervisory dialogue with relevant so-called Class 1 investment firms.

About us

PwC Legal is assisting a number of financial services firms and market participants in forward planning for changes stemming from these proposals.

If you would like to discuss any of the developments mentioned above, or how they may affect your business more generally, please contact any of our key contacts or PwC Legal's RegCORE Team via de_regcore@pwc.com or our website.

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