

RegCORE Client Alert

Financial Services: ESMA steps in to support European Commission's report on asset managers' use of reverse solicitation

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QuickTake

The European Securities and Markets Authority (**ESMA**) has picked up its supervisory policy work in 2022 in much the same way as it did at the start of 2021 by commenting on the use of reverse solicitation in the Member States. In 2021, days after the UK left the "Transition Period", ESMA provided all financial services firms with a stark reminder setting out supervisory expectations in light of what it considered "questionable practices" by third country firms using reverse solicitation.

At the start of 2022, ESMA's published its limited findings on the use of reverse solicitation by asset managers following a survey conducted with the national competent authorities (**NCA**s) (**ESMA's Reverse Solicitation Letter 2022**). It also suggested policy options for the European Commission (**EC**) to consider in order to better collect data on such use. ESMA's 2022 letter is a response to the EC's request for assistance in publishing a report on how asset managers use reverse solicitation. This study is part of a more general analysis and report that the EC will publish in respect of the functioning of the EU's Regulation on Cross-Border Distribution of Funds (**CBFDR**), which has been in place since 2019. A key question in the EC's report will consider how reverse solicitation may adversely impact the functioning of the EU's passporting regime, which is of course a regime, a core pillar of the functioning of the EU's Single Market for financial services.

While ESMA's Reverse Solicitation Letter 2022 provides valuable insight as to what the EC might do next as part of its analysis and reporting of the functioning of the CBFDR, the points raised by ESMA may also be replicated across financial services and thus regulated market participants beyond the asset management sector. Both EU and non-EU domiciled firms will want to take note and plan accordingly if further rulemaking or supervisory expectations on the use of reverse solicitation could move from policy options to supervisory scrutiny.



Background

The use of “reverse solicitation” by both EU firms operating across the EU as well as those from further afield, i.e., in “third countries” (which following Brexit, includes the UK) has long been in the supervisory spotlight of ESMA as well as NCAs across EU Member States. Regulatory policymakers and supervisors are increasingly beginning to step up supervisory scrutiny of how reverse solicitation is being applied by financial services firms.

While the term of “reverse solicitation” is not explicitly defined in EU legislation, EU regulatory policymakers have delineated the concept as covering situations whereby a client (i.e., in the EU) at its own exclusive initiative requests services from a firm (whether an EU or non-EU firm) that is not authorised to provide services to the client in the jurisdiction in which that client is based. However, the exact extent to what reverse solicitation encompasses and is allowed in the Member States is not determined.¹ ESMA and other EU-authorities along with NCAs had all issued a number of general principles setting supervisory expectations as well as more specific warnings to financial services firms during the Brexit negotiation period and following the UK’s full exit from the UK-EU Transition Period.²

As 2022 got started, asset managers are now in ESMA’s Reverse Solicitation Letter 2022 (published 3 January 2022 but dated 17 December 2021), the latest set of firms to be placed into focus.³ The EC is required pursuant to Art. 18 of the EU’s CBFDR (also referred by some as the “CMR” regime which goes hand in hand with an EU Directive, the “CMD”)⁴ to prepare and submit, following consultation with NCAs,⁵ ESMA and other relevant stakeholders a report detailing: (i) the extent of use of reverse solicitation, (ii) the demand exhibited by investors acting on own initiative; (iii) the extent of impact of points (i) and (ii) on the level and volume of subscription into funds and geographical considerations (including third countries) and (iv) the impact of the use or reverse solicitation on the EU’s passporting regime. Ultimately, the EC’s core aim is to assess whether the reverse solicitation may be working better in securing investments in the asset management sector than the use of the EU’s passporting regime as well as the reforms in the CBFDR.

In addition to the above, the EC’s forthcoming report is also required to examine whether a “notification portal”, as contemplated by Art 13(2) of the CBFDR, should be established so as to better facilitate transfers of documents and reporting data between NCAs concerning cross-border distribution of funds. At its core, the notification portal aims to support ESMA in establishing a “central database on cross-border marketing of AIFs and UCITS”. This central database is required to be publicly available on ESMA’s website.⁶

ESMA is supposed to have completed the work on both the notification portal and the central database by 2 February 2022. Given the impact of COVID-19 and the delay to the EC’s own report as well as ESMA’s findings below (notably that insufficient data is currently available), the completion date of all these workstreams will likely slip. No firm completion date has been communicated, save for the fact that ESMA has committed in its own 2022 Supervisory Work Programme to prioritise this workstream as part of its 2022 IT Budget (see standalone coverage from PwC Legal’s EU RegCORE team on ESMA’s 2022 Supervisory Work Programme).

Findings in ESMA’s Reverse Solicitation Letter 2022

Following the survey with the NCAs ESMA’s Reverse Solicitation Letter 2022 reached its main conclusion that there is no sufficient data available to draw conclusions to what the EC is expected to report on. This is largely due to the absence of a harmonised reporting regime on the use of reverse solicitation in the asset

¹ See also the similar discussion on a definition of pre-marketing.

² See our further dedicated coverage from us on inter alia the European Supervisory Authorities’ supervisory warnings on permitted use of reverse solicitation and as well as supervisory principles on relocations (**SPoRs**).

³ ESMA’s letter is available [here](#).

⁴ EU Regulation 2019/1156 available [here](#). The CMD and the CMR are available [here](#) and [here](#) and the Implementing Technical Standards [here](#) and final report on ESMA Guidelines [here](#).

⁵ To which ESMA received replies of the NCAs of the following EEA states: Denmark, Cyprus, Greece, Sweden, Iceland, Slovak Republic, Estonia, Slovenia, Belgium, Portugal, Italy, Croatia, France, Latvia, Bulgaria, Luxembourg, Romania, The Netherlands, Liechtenstein, Czechia, Lithuania, Germany, Norway, Austria, Malta, Finland, Ireland, Spain and Poland.

⁶ Specifically, the central database (which collates data received from NCAs) should list:

- (A) all (i) AIFs that are marketed in a Member State other than the home Member State, (ii) the AIF Manager or for the purposes of European Social Entrepreneurial Funds (EuSEF) regime and for purposes of the European Venture Capital Funds (EuVECA) regime the relevant Manager and (iii) the EU Member States in which they are marketed; and
- (B) all (i) UCITS that are marketed in a Member State other than the home Member State, (ii) the UCITS Management Company and (iii) the EU Member States in which they are marketed.

management sector and there only being a limited number of national reporting requirements in very few Member States.⁷ Where these do exist, they differ from one another, as to the local market specifics. This conclusion is telling in its own right that a high(er) degree of fragmentation remains, despite various legislative and regulatory harmonisation efforts being advanced by the EC (as well as ESMA) in the asset management sector, most recently through the introduction of CBFDR.

ESMA's Reverse Solicitation Letter 2022 set out the following findings:

1. Under EU law asset managers are not subject to any harmonised obligation to report to their NCAs any subscriptions into funds that arise from the use of reverse solicitation. This is the case irrespective of Member States legislative and regulatory frameworks containing "local" reporting requirements. ESMA flagged that "... almost all NCAs have no readily available information [to provide ESMA] on the use of reverse solicitation either via asset managers or investor associations..." certainly when compared to marketing;
2. For the jurisdictions that were able to provide ESMA with statistical information, namely Cyprus and Italy, the results evidenced a clear and significant use of reverse solicitation. As an example:
 - a. the Italian NCA, CONSOB, reported that in 2020 approximately 25% of total subscriptions in fund investments gathered by Italian asset managers (excluding the amount that had been sourced through third-party distributors) were concluded and obtained on the basis of reverse solicitation. Interestingly, ESMA noted that in approximately 99% of those cases, subscriptions were from professional investors and frequently (but not exclusively) in the context of setting up bespoke alternative investment funds (AIFs under the EU's AIFMD legislative and regulatory framework)⁸. Specifically, ESMA's letter cited the example of a "...real estate fund where the invested real estate assets are delivered to the fund by the investors.";
 - b. the Cypriot NCA, CySEC, submitted data evidencing that 30% of UCITS Management Companies of funds under the EU's UCITS regime⁹ and 50% of AIF Managers established in Cyprus employed reverse solicitation practices;
 - c. the Spanish NCA, the CNMV, notified ESMA that they "...did not have any information on reverse solicitation but that 1.35% of the total assets under management of funds established in Spain are owned by foreign investors and since Spanish funds are hardly marketed outside Spain, this figure could be used as a proxy to assess reverse solicitation in Spain."; and
3. Unsurprisingly, ESMA noted that a number of NCAs were of the view (our emphasis in bold) that **"...reverse solicitation is used in practice to circumvent the rules of the third-country and EU passport regimes**, which raises some concerns in terms of investor protection but may also **create an unlevel playing field between EU asset managers and non-EU asset managers** operating in the [European] Union via reverse solicitation." However, this view cannot (yet) be supported by sufficient data.

In addition to its findings, ESMA proposed that the European Commission could consider implementing the following "improvements" to source and collate additional information on how asset management firms (but possibly extended at some point to other types of financial services firms more generally) use reverse

⁷ Specifically, ESMA stated (Page 2 of its letter) that "Unfortunately, in the absence of quantitative data for other Member States, it is difficult to at this stage to draw any conclusion for the rest of the [European] Union."

⁸ The alternative investment fund managers (AIFM) directive covers managers of alternative investment schemes designed for professional investors. Alternative investment funds are funds that are not regulated at EU level by the UCITS Directive (see below). They include hedge funds, private equity funds, real estate funds and a wide range of other types of institutional funds. Since its adoption in 2011, the AIFMD has supported the creation of an efficient single market for alternative investment funds (AIFs) and built a strong regulatory and supervisory framework for AIFMs in the EU. As part of the capital markets union (CMU) 2.0/2.5 package of 25 November 2021, the EC adopted a legislative proposal that recommends amending the AIFMD framework in order to make the AIF market even more efficient, improve investor protection and enable better monitoring and managing of risks to financial stability.

⁹ UCITS or 'undertakings for the collective investment in transferable securities' are investment funds regulated at European Union level. They account for around 75% of all collective investments by small investors in Europe. The legislative instrument covering these funds is Directive 2014/91/EU. As these funds are regulated at EU level, they can be marketed across the EU without having to be concerned with which country a fund is domiciled in, thanks to a straightforward notification procedure. It saves costs for fund providers, as they no longer have to create specific funds for each market. The creation of the UCITS regime furthered the EU's goal of a single market for financial services in Europe and provided a highly effective mechanism for both investors in funds and investment managers creating investment products. The marketing passport for investment funds is one of the most significant developments in European financial services of the last 30 years.

solicitation, where and with respect to which products and client types. These new suggested improvements would include the European Commission:

- A. engaging directly with market participants, including but not limited to asset managers, depositories or account holders possibly through national and European trade associations. It should be noted that such power would be voluntary, and this might pose problems for data quality; and
- B. as an alternative, the European Commission could consider introducing mandatory data collection powers, then it would have to do so in either a targeted manner or more broadly by way of legislative act creating then of course new regulatory reporting obligations for firms that are in scope of that obligation.

Outlook and next steps

It is not surprising that hardly any data is available on reverse solicitation since it does not fall under the regulatory framework. While the EU took further steps with regard to the cross-border distribution of funds with its Directive 2019/1160¹⁰ - in particular putting up notification requirements for an EU AIFM its intention to pre-market an AIF and any subscription within 18 months of that pre-marketing requiring a full notification for marketing approval, it does not encompass a reporting obligation for sole reverse solicitation cases as this is not considered pre-marketing. Still, ESMA's Reverse Solicitation Letter 2022, its findings and as a result its policy options proposed to the European Commission indicate that greater information gathering powers, whether by voluntary or mandatory means, are likely to be on the way. Equally, the letter hints at the issue that much is still needed to be done in order for the CBDFR regime, which was supposed to facilitate greater cross-border distribution of funds as well as a single database, as hosted by ESMA, will be established and that this will in turn play its parts in wider-reaching reforms on greater exchange of data amongst NCAs and centralised collation by the European Supervisory Authorities, notably ESMA for all EU financial markets sectors.

While these changes are likely to advance for asset managers first and follow for other sectors of financial markets more generally, they will not be piecemeal. Notably those regulated financial services providers will want to forward plan what these developments mean for their own reporting obligations along with relevant documented policies and procedures as well as systems and controls more generally and how to capture data points along the process. The developments discussed above therefore not only apply to asset management (notably the differing types of regulated funds they manage) firms but across other types of firms as well.

Firms that engage well in forward planning in how to meet these immediate and longer-term these requirements and can scenario plan how to extend efficiencies gained in one process across to others, will do better both in terms of their reporting as well as compliance efforts but possibly also business generation efforts.

The developments discussed above might also prompt some firms to take a more strategic view in how they engage with their prospective investors, market counterparts and clients. If the direction of travel continues that EU regulatory policymaking and supervisory scrutiny steps up on reforming and ultimately rolling-back how (including how frequently), when, where and with firms should and can use reverse solicitation, then both EU and non-EU firms will want to take pre-emptive measures to ensure they comply with applicable requirements and supervisory expectations in an agile manner so as to be able to continue to conduct business in a compliant and sustainable manner.

This Client Alert should be read in conjunction with forthcoming coverage on the EU's aforementioned report and other specialist publications from PwC Legal's RegCORE team as may be made available from time to time.

¹⁰ which came into effect on 2 August 2021.

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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