RegCORE Client Alert

Revisiting ESMA's supervisory expectations on reverse solicitation

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QuickTake

Reverse solicitation, also known as reverse enquiry, refers to circumstances in which a prospective client approaches a regulated financial services firm at its own exclusive initiative and requests services and/or products from that financial services firm. The enquiry must not be in response to advertising or marketing of any kind. Reverse solicitation is not (currently) regulated in the same manner across all EU financial services legislative and regulatory frameworks in a harmonised manner. Instead, it is regulated in individual cornerstone pieces of legislation, such as MiFID II for securities and investments business. Some legislative and regulatory frameworks in the EU may be altogether silent on reverse solicitation.

For financial services firms operating without EU Single Market passporting rights but equally for those firms operating in "third-countries" i.e., outside the EU/EEA, reverse solicitation may allow them to service EU/EEA clients from that (third country) jurisdiction and do so without triggering EU as well as local license requirements in the jurisdiction where the client requesting the services is based.[1] However and rather importantly for third-country firms, even where a client has initiated a business relationship on the basis of reverse solicitation with that (third-county) firm, that firm cannot offer further services to an EU/EEA client other than those that the client had requested of it.

1 Pursuant to Article 42 of MiFID II, where a firm provides investment services on the basis of reverse solicitation to a retail client or an elective professional client, that firm does not trigger the authorisation requirement (including the establishment of a branch pursuant to Article 39 MiFID II. Where a third-country firm provides services at the own exclusive initiative of the client under Article 42, the firm is not able to market additional categories of products or services to that client. Firms should be mindful of and follow the guidance set out in ESMA's Q&As on MiFID II and Markets in Financial Instruments Regulations (MiFIR) investor protection and intermediaries topics (ESMA Q&A) in relation to the application of the concept of "own exclusive initiative". Where a third-country firm solicits clients or potential clients or promotes or advertises investment services or activities in the EU, such services cannot be deemed to be provided at the own exclusive initiative of the client. This is true regardless of any contractual clause or disclaimer purporting the opposite (Recital 111 of MiFID II).

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Reverse solicitation rapidly returned to the regulatory spotlight when the European Securities and Markets Authority (**ESMA**) published a reminder at the start of 2021[2] setting out its supervisory expectations. These come after ESMA identified, certainly in the context of activity regulated under MiFID II (clarifications in square brackets) "[…] some questionable practices by [non-EU-27/EEA firms] around reverse solicitation […]"

ESMA went on further to state that certain firms "[…] appear to be trying to circumvent MiFID II requirements by including general clauses in their Terms of Business or through the use of online pop-up "I agree" boxes whereby clients state that any transaction is executed on the exclusive initiative of the client."

On 17 December 2021 (but only published 3 January 2022), ESMA wrote to the European Commission[3] in response to its call for evidence on the use of reverse solicitation and in the context of the EU's Cross-Border Funds Distribution (**CBFD**) Directive[4] regime. As part of that call for evidence, ESMA concluded that limited information on the use of reverse solicitation was available from national competent authorities (**NCA**s).

Where such information was available ESMA concluded that the level of reverse solicitation being employed was of a "significant size".[5] ESMA concluded in that letter that "[…] if there was willingness to fill in this information gap on a more permanent basis at the European level, consideration should be given to the introduction of new reporting requirements allowing to collect information on reverse solicitation across the EU."[6] While such a pan-EU new reporting regime is not likely to materialise in the short term it is a matter that could well be pursued as a "quick win" nevertheless.[7]

This Client Alert reassesses both of these publications in light of further regulatory and supervisory policymaking, now that both ESMA and NCAs are returning to more normal operations including a return to using "common supervisory actions"[8] and onsite investigations as part of their supervisory engagement following the more disruptive phases of the COVID-19 pandemic now appearing to have passed.

Points that firms will still want to consider

ESMA's 2021 publications point out that it as well as the NCAs are aware of the risk posed by the potential overuse and misuse by some firms' reliance on reverse solicitation as part of their business models and activities. Moreover, ESMA communicated a need for the European Commission to consider targeted legislative changes to harmonise the definition of reverse solicitation as a whole along with the permitted uses and relevant reporting by EU and third-country firms to NCAs and indeed to ESMA in particular for certain products, notably funds.

As stated above, while such reform is unlikely to materialise in the short term, it is potentially an easy "quick win" from a policymaking and legislative drafting perspective over the medium term during the forthcoming legislative and supervisory policymaking cycles. As indeed the European Commission as well as ESMA policymaking has in the past shown, if there are doubts on the extent of a perceived problem or shortcomings in market practice, then collecting data is one means of compelling market participants to improve their behaviour. Certain NCAs[9] have already gone further than ESMA's public statements in publishing their own supervisory guidance on reverse solicitation and what is permitted. Such NCA specific guidance however fuels rather than reduces risks of fragmentation on when and on what basis reverse solicitation may be permitted.

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2 See here.
3 See here.
4 Directive 2019/1160, which came into effect on 2 August 2021, has limited the ability to rely on reverse solicitation. This is the case as an EU-manager of an alternative investment fund (AIF) is required to notify the regulators of its intention to pre-market an AIF and any subscription within 18 months of that pre-marketing requiring a full notification for marketing approval. That being said the CBFD does not impose a reporting obligation on the AIF Manager where no pre-marketing has taken place and thus where there is solely reverse solicitation.
5 Most NCAs do not require data on the use of reverse solicitation to be reported to them. Cyprus and Italy are however jurisdictions where the Italian NCA, CONSOB and the Cypriot NCA, CySEC do require such reporting. CONSOB reported to ESMA that 25% of total subscriptions of funds during 2020 (given that this was the focus of the call for evidence) were gathered by Italian asset managers were made via reverse solicitation by professional investors. CySEC reported that 30% of Cyprus-based UCITS Management Companies and 50% of Cypriot alternative investment fund managers rely on reverse solicitation.
6 EMSA also in its letter confirmed that the Notification Portal allowing NCAs to exchange notifications of cross-border marketing of funds was prioritised in the 2022 IT budget of ESMA and that equally ESMA staff will continue to support the European Commission's efforts to further modernise and standardise supervisory reporting systems.
7 See thought leadership coverage from PwC Legal's EU RegCORE available here on this topic as well as recent developments concerning the use of tied agents available here.
8 i.e., coordinated multi-NCA set of regulatory investigations including on-site inspections that may be coordinated by ESMA.
9 Notably the French Financial Markets Authority (AMF) whose Enforcement Committee in its Decision No.4 dated 26 April 2022 (SAN-2022-05) (available here – in French only) with further context published in its press release (available here), reaffirmed the AMF's strict interpretation of what it considers "reverse solicitation" and sets out key considerations that the AMF had set in relation both in its implementation of Art. 42 MiFID II into French law but also in its AMF Position Recommendation Doc 2014-04 (see Section 1 available here).

As a general observation, while reverse solicitation as a permitted means of servicing clients' requests may not be a dead-end, it is certainly being reigned in and should be seen as more the exception than the rule when running a business into or across the EU by firms not authorised and regulated in the EU-27 to be able to do so. Consequently, firms (in the EU acting on a cross-border basis but also more crucially, those operating in third-countries) should continue to:

1. observe the boundaries of the relevant regulatory perimeter applicable in the EU and the Member States as ESMA's 2021 supervisory warning states that "[…] the provision of investment services in the EU without proper authorisation in accordance with the EU and the national law applicable in Member States exposes service providers to the risk of administrative or criminal proceedings, for the application of relevant sanctions". Notably these can and have been levied against third-country firms and key function holders of those firms. In some instances, this can also apply when tied agents or other distributors may be acting for a third country firm. In conclusion to its 2021 supervisory warning, ESMA further stated that "[….] when using the services of investment service providers which are not properly authorised in accordance with EU and Member States' law, investors may lose protections granted to them under EU relevant rules, including coverage under the investor compensation schemes in accordance with Directive 97/9/EC" – which may increase the risk of litigation including collective actions;

2. review their existing and new arrangements on a client-by-client as well as a transaction-by-transaction basis and assess whether they can or indeed should rely on reverse solicitation;

3. assess all their client facing communications channels and those of distributors for compliance with requisite requirements, even if not explicitly targeting a specific market or customer type, as ESMA has confirmed it, as well as NCAs, will review all types of materials, including but not limited to press releases, internet-based advertisements (including social media)[10], phone calls and/or face-to-face meetings. A further area also concerns the use of mobile applications and how these are made available and which app stores;

4. ensure they have sufficiently detailed and robust evidence to show how, when and on what basis for what precise products and services the client approached the firm and whether it was at its own exclusive initiative or that there is no evidence to the contrary. Importantly this requires a periodic review that the "own exclusive initiative" test is applied on a service by service or product by product basis as opposed to a relationship basis[11]; and

5. be sensitive to the fact that an overuse of reverse solicitation will be presumed to be misuse which will not be tolerated. The same applies to attempts at circumventing principles and supervisory expectations.

Outlook and next steps

ESMA's supervisory statements in 2021 were unequivocally clear in its expectations of market participants as well as points that NCAs should consider when carrying out their supervisory mandates as well as the messaging to the European Commission in a need for further rulemaking. The European Commission would, if it decides to follow ESMA's efforts to reign in the overuse and/or misuse of reverse solicitation, also have to consider input from ESMA's sister authorities the European Banking Authority (**EBA**) as well as the European Insurance and Occupational Pensions Authority (**EIOPA**) and possibly, in the context of the Banking Union, the European Central Bank (**ECB**) acting in its role at the head of the Single Supervisory Mechanism (**SSM**).

In considering the specifics that apply to each of those areas of financial markets and supervision under those authorities' respective mandates, the European Commission could introduce much more harmonised rules that would also empower NCAs in their supervisory remit while still allowing for flexibility to accommodate jurisdiction-specifics. This would be welcome in terms of reducing fragmentation but may mean firms will need to make amendments to certain policies and procedures for how they engage with clients where they cannot or choose not to rely on EU passporting rights. If such future rulemaking is not forthcoming from the European Commission, then ESMA, possibly in conjunction with the EBA and EIOPA, may publish its own (joint-)

10 See for example thought leadership coverage form PwC Legal's EU RegCORE on the German NCA's warning for investment advice and tips using social media or messenger services available here.

11 This means that after a client relationship having been established between a third-country firm and an EU-27 client, that such firm cannot provide new products and services to that client unless such additional services have also expressly been requested at the sole and exclusive initiative of that client. Some ambiguity (and thus regulatory risk) exists as to whether that third-country firm may provide a repeat of similar services/product type for that client.

guidance setting further supervisory expectations that firms and indeed NCAs will need to consider and which they then should follow in their marketing and market-access strategies.

In light of the above, many firms, especially those in third-countries, may want to draft and maintain a reverse solicitation policy and procedures document that considers the EU-level supervisory expectations along with those in individual Member States as well as client-type and product/service-type specific considerations. Such a policy and/or procedures document may also help with the points that firms will want to take note of and continue to comply with that were discussed above.

About us

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

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 EU RegCORE Team via de_regcore@pwc.com or our website.

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