

THE REGIME FOR THIRD COUNTRY FIRMS UNDER MiFIDII/MiFIR – THE OUTLOOK FROM SPAIN

MiFID I did not have a harmonised regime for firms domiciled outside the European Union (EU) operating and offering services in the EU. MiFID II/MiFIR introduces a radical change, harmonising the regime under which these firms can offer investment services in the EU, albeit establishing different regimes depending on the type of clients that receive the services.

The regime under MiFID I

MiFID I grants each Member State the discretion on how to treat entities that are domiciled outside the EU which provide investment services in the EU, either by establishing a branch or under the free provision of services regime ("Foreign Firms"). There is no harmonisation of the rules, so for example, a US entity looking to provide investment services in Spain, Germany and Luxembourg, either by opening a branch or under the free provision of services regime, has to comply with the different requirements in each country. In addition, the authorisation obtained in one country only enables the Foreign Firm to provide services in that country, as there is no EU-wide passport.

The regime under MiFID II/MiFIR

The new regime under MiFIDII/MiFIR introduces changes to the type of client that can receive the service.

Retail clients and retail clients that request to be treated as professionals (elective professionals)

In this case, MiFID II/MiFIR grants Member States the discretion (but not the obligation) to require that Foreign Firms operate in their territory through a branch, prohibiting them from acting on a free provision of services basis and obliging them to open a permanent establishment in the EU.

MiFID II sets out the conditions that Foreign Firms must meet in order to be able to open a branch. These conditions, which are the same for all Member States and thus create a harmonised regime, are:

- Existence of cooperation agreements between the authorities of the third country and those of the EU Member State where the branch is to be opened
- Existence of tax agreements between the two countries

Key issues

- MiFIDII/MiFIR introduces changes to the Third Country Regime
- There will be different options, depending on the type of client
- Member states will have discretion to decide if local branches are required in some circumstances
- The Spanish regulator has not yet stated its position on this issue
- Current business models might be affected post Brexit
- Firms operating under the Third Country Regime should consider the issues well in advance of the 1 January 2018 MiFIDII/MiFIR implementation date

- Compliance with FATF recommendations.
- Obligation for the investment services that the Foreign Firm wants to provide in the EU to be subject to authorisation and supervision in the third country. This means that no unregulated Foreign Firms will be able to open branches in the EU and also limits the activities that these entities can perform via branches to activities that are regulated and authorised in the third country
- The Foreign Firm must belong to an investor-compensation scheme authorised or recognised in accordance with Directive 97/9/EC
- The branch must have sufficient initial capital and designate one or more managers of the branch who must meet certain requirements

If a Member State opts for this regime, it will have 6 months from receipt of the application from the Foreign Firm in which to respond. In addition, the Member State must not impose additional requirements for the organisation and operation of the branch, or apply a more favourable regime to these branches than the one that exists for EU entities.

If a Member State does not opt for this regime, they can continue to impose their own national rules. Countries like the UK have already indicated that they will not be adopting this alternative and will continue to allow Foreign Firms to provide investment services in the UK without a branch and to continue benefitting from exemptions such as the overseas persons exemption.

It may be that more conservative EU countries will adopt this alternative,

and stipulate that Foreign Firms can only provide investment services to retail or elective professionals if they establish a branch in their territory.

In Spain, the CNMV has not yet stated its position. If it adopts this alternative it could have a major impact on the business model of Foreign Firms in Spain. Foreign Firms usually act in Spain via subsidiaries incorporated elsewhere in the EU, particularly in the UK. As such, there are very few Foreign Firms that operate directly in Spain from their country of origin (according to the current registry of investment services companies at the CNMV, there are only 3 Foreign Firms acting on a free provision of services basis, and none through a branch).

In the context of Brexit this will have an impact, as the UK subsidiaries will become Foreign Firms. In that case, the CNMV may require that UK entities, which are currently passported on a free provision of services basis (over 2000 firms) and therefore acting without a presence in Spain, establish a branch and have a physical presence in the country, if they want to continue providing services to retail and elective professionals in Spain. It remains to be seen what position Spain ultimately takes on this point and whether the UK reaches an agreement with the EU in this regard.

Per se professional clients and eligible counterparties

Foreign Firms will be able to provide investment services in the EU to per se professional clients and eligible counterparties on a free provision of services basis, without the need to establish a branch, provided the entities are registered as third country

entities with ESMA. Unlike MiFID I, which required authorisation from each Member State, MiFID II only requires the Foreign Firm to be recorded in the ESMA register, which will depend on the following conditions being met:

- that the European Commission has adopted an equivalence decision with regard to the prudential and conduct requirements in the third country and that the legal framework of the third country envisages an equivalent effective system for recognition of firms authorised in the EU
- that the Foreign Firm is authorised in the third country to provide investment services and is subject to effective supervision and monitoring
- that cooperation agreements are in place between ESMA and the third country authorities

Member States cannot impose any additional requirements to those contemplated in MiFID II/MiFIR, although they must not treat third country firms more favourably than EU firms.

Before providing any investment service, Foreign Firms must inform clients established in the EU, clearly and in writing, that they are not authorised to provide services to clients other than per se professional clients or eligible counterparties and that they are not subject to EU supervision. Moreover, they must indicate the name and address of the competent authority responsible for their supervision and offer clients the possibility of submitting any potential dispute to the jurisdiction of a court or court of arbitration in a Member State.

Transitional arrangements

Foreign Firms may continue to provide investment services in Member States in accordance with their national regimes for three years after adoption by the Commission of an equivalence decision in relation to the relevant third country. For example, if the Commission adopts an equivalence decision with regard to the USA effective as of 1 January 2020, US entities would be able to continue providing investment services until 1 January 2023 under the national regimes existing in the EU (e.g. in the UK under the overseas person exemption). However, it appears that this transitional period only applies to *per se* professional clients and eligible counterparties.

In addition, if there is no equivalence decision regarding a third country, entities of that third country would not be able to register with ESMA. However, Member States have the discretion to allow these entities to provide investment services to *per se* professional clients and eligible counterparties, in accordance with their national regimes.

Client initiative

MiFID II contains an exemption in circumstances where it is the client (professional or retail) who takes the initiative and requests the provision of investment services from a Foreign Firm. In this case, MiFID II will not apply and, therefore, there will be no need to establish a branch or apply for registration with ESMA.

However, what constitutes 'client initiative' must be interpreted restrictively and on a case-by-case

basis: the Foreign Firm will only be able to provide the services or products specifically requested by the client and will not be permitted to provide or market new investment services or products unless this is also due to a client initiative.

Impact on business models

Foreign Firms should start analysing what structures they have in the EU, what clients they want to target and how MiFID II might affect their business models prior to 3 January 2018, which is the date on which MiFID II /MiFIR is to enter into force.

Issues to be considered include:

- If the Foreign Firm wants to provide services to retail and elective professionals, it is possible that certain jurisdictions (the most conservative EU ones) will require that they open a branch. This means that they will have to apply for authorisation in each such Member State in which they want to operate. Under MiFID II, for the provision of services to retail and elective professionals, there is still no passport for branches and authorisation must be obtained on a state-by-state basis.
- If a Member State requires the opening of a branch to provide investment services to retail and elective professionals, a Foreign Firm will not be able to provide such services without opening a branch *unless* the service is provided at the initiative of the client.
- If the Foreign Firm wants to provide services to *per se* professional clients and eligible counterparties only, it will be sufficient for the Foreign Firm to be registered with ESMA in order to provide such services to this kind of client throughout the EU. This registration will not be necessary if the service is provided at the initiative of the client.
- It is also possible to benefit from a combination of the two approaches: that is, establish a branch in a Member State in order to provide services to retail and elective professionals and, from that branch, act on a free provision of services basis in other Member States to provide services to *per se* professional clients and eligible counterparties, without establishing new branches, provided the Commission has issued an equivalence decision with regard to the third country. If the Member State has not adopted the obligatory branch regime under MiFID II, or if the Commission has not issued an equivalence decision with regard to the third country, this route would not be available.
- It is possible that many Foreign Firms will not be affected by MiFID II as they operate in the EU via subsidiaries incorporated in the EU. However, if the subsidiaries are in the UK, Brexit will mean that the issues discussed above will apply, as UK subsidiaries will become Foreign Firms.

The Third Country Regime under MiFIDII/MiFIR

The regime for third country entities is set out in

- Articles 39 to 42 of Directive 2014/65, of the European Parliament and of the Council of 15 May 2014 (**MiFID II**).
- Articles 46 to 49 of Regulation (EU) no. 600/2014 of the European Parliament and of the Council of 15 May 2014 (**MiFIR**).
- Commission Delegated Regulation (EU) 2016/2022 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards concerning the information for registration of third-country firms and the format of information to be provided to the clients (Text with EEA relevance).

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