

Risk Management

ESMA Work Programme Provides Hedge Fund Managers with Key Guidance About E.U. Financial Services Legislation

Oct. 15, 2015

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The European Securities and Markets Authority (ESMA) has published its **2016 Work Programme** (Program), setting out for hedge fund managers and other market players its key priorities and planned activities in the E.U. financial services arena for next year. The Program represents the first phase of ESMA's Strategic Orientation 2016-2020, formulated following a strategic planning exercise earlier this year, and sees the supervisory body shift its attention away from rulemaking, toward implementation of the single rulebook developed over the preceding five years and enhancement of supervisory convergence among the various national financial services regulators across Europe.

The Program is divided into three main sections covering: the single rulebook for European financial markets; risks to investors, markets and financial stability; and supervisory convergence. This is the first time that ESMA has produced a dedicated work program in respect of its supervisory convergence activity, for which ESMA notes that cooperation with other European supervisory bodies will be vital. The Program also highlights for hedge fund managers areas where ESMA will work with international organizations, European regulators and third-country supervisory authorities.

Following the annual statement earlier this month by ESMA's Chair to the Economic & Monetary Affairs Committee of the European Parliament, which highlighted some key goals for the year ahead, the Program now affords hedge fund managers and other market participants a more granular insight into the supervisor's work plans. See "**ESMA Chair Highlights Upcoming Focus on Supervisory Convergence**," *Hedge Fund Law Report*, Vol. 8, No. 38 (Oct. 1, 2015). In particular, it identifies specific guidance, advice and measures that will be promulgated in the upcoming year under the European financial markets regime that will affect hedge fund managers' operations, in areas including reporting requirements, clearing obligations and European investment fund legislation. This article summarizes the key provisions of the Program.

For more on European supervisory initiatives, see "**European Regulator Issues Guidance to Market Participants on Penalties for Settlement Failures**," *Hedge Fund Law Report*, Vol. 8, No. 38 (Oct. 1, 2015); and "**European Commissioner Calls for Economic and Regulatory Coordination**," *Hedge Fund Law Report*, Vol. 8, No. 39 (Oct. 8, 2015).

Single Rulebook for European Financial Markets

While the majority of development work on the single rulebook approaches completion, ESMA sets out various areas of policy development, where its tasks will include providing technical advice on legislation to the European Commission (Commission); drafting Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS); and issuing advice and guidelines on the application of E.U. law.

The Program, which is based on a total budget of €40,437,589 determined on the basis of the planned activities, does not include potential new tasks arising in connection with the **Capital Markets Union (CMU) Action Plan**, which had yet to be finalized during the preparation of the Program.

Credit Rating Agency Policy

ESMA will produce guidance on the following three areas: valuation methodologies; fees charged by credit ratings agencies (CRAs); and the reduction of ratings reliance. Additionally, ESMA will advise the Commission about third-country equivalence and will annually publish information about E.U.-registered CRAs on its website.

ESMA will develop up to five templates to be integrated into the RTS on structured finance instrument (SFI) disclosures.

Markets in Financial Instruments Directive (MiFID II) and Markets in Financial Instruments Regulation (MiFIR)

ESMA will produce between fifteen and eighteen technical standards, two of which are likely to specify trading obligations for two different classes of derivatives and one of which will relate to the consolidated tape for non-equity instruments. For more on MiFID II, see, “**ESMA Releases Final Report on MiFID II Technical Standards for Hedge Fund Management Firms**,” Hedge Fund Law Report, Vol. 8, No. 28 (Jul. 16, 2015); and “**MiFID II Expands MiFID I and Imposes Reporting Requirements on Asset Managers, Including Non-E.U. Asset Managers**,” Hedge Fund Law Report, Vol. 8, No. 21 (May 28, 2015).

Corporate Reporting

Under the Transparency Directive, ESMA must assess potential electronic reporting formats and prepare draft RTS specifying the European Single Electronic Format. Seeking to contribute to European standard setting and to improve the transparency and usefulness of financial statements and the enforceability of International Financial Reporting Standards, ESMA will also issue a number of comment letters to the International Accounting Standards Board and the European Financial Reporting Advisory Group.

Benchmark Policy

Following the approval of Level 1 measures on benchmarks, ESMA will deliver up to sixteen technical standards and up to ten sets of technical advice. It will also be responsible for maintaining registers and will coordinate with third countries as well as the other European Supervisory Authorities.

Market Abuse and Short Selling

Upon the delivery of a mandate from the Commission, ESMA will evaluate, and report on, the appropriateness and impact of the Short Selling Regulation.

European Investment Fund Legislation

During 2016, ESMA will produce technical advice on the depositary frameworks of non-E.U. jurisdictions, in the context of the Alternative Investment Fund Managers Directive (AIFMD). It will also continue to provide advice regarding the possible extension of AIFMD's passport to alternative investment fund managers (AIFMs) and alternative investment funds in third-country jurisdictions, while considering the potential termination of national private placement regimes. See "[ESMA Recommends Extension of the AIFMD Passport for Hedge Fund Managers and Funds in Certain Non-E.U. Jurisdictions](#)," Hedge Fund Law Report, Vol. 8, No. 31 (Aug. 6, 2015).

ESMA further expects to provide advice and produce draft technical standards on the Money Market Funds Regulation.

Securities Financing Transactions Regulation

In relation to the Securities Financing Transactions Regulation (SFTR), ESMA will prepare draft RTS and ITS by the end of next year. These will cover the definition and format of reports to be submitted to trade repositories; the information to be made available to national competent authorities (NCAs); and the information required for the registration of trade repositories for SFTR purposes.

European Market Infrastructures Regulation (EMIR) Clearing Obligation

Prior to the end of 2016, ESMA will prepare RTS in relation to the clearing obligation under EMIR, determining the classes of over-the-counter (OTC) derivatives to be subject to such obligation. If deemed appropriate, it may amend the RTS on central counterparties (CCP) requirements.

For more on EMIR, see, "[Central Counterparty Liquidation Period May Be Shortened Under EMIR to Conform to U.S. Regime](#)," Hedge Fund Law Report, Vol. 8, No. 35 (Sep. 10, 2015); and "[EMIR Offers Three Models of Asset Segregation to Fund Managers That Trade OTC Derivatives](#)," Hedge Fund Law Report, Vol. 8, No. 15 (Apr. 16, 2015).

Packaged Retail and Insurance-based Investment Products

In the context of the Packaged Retail and Insurance-based Investment Products regulation, ESMA will continue work on technical standards and provide technical advice over the course of next year.

Assessing Risks to Investors, Markets and Financial Stability

The Program states that ESMA will further intensify its cooperation with E.U. institutions, European Supervisory Authorities, the European Systemic Risk Board and international organizations.

Drawing on proprietary data, commercial data, market intelligence, expert assessments and other sources (including new data available through AIFMD reporting), ESMA will publish a Report on Trends, Risks and Vulnerabilities in the first and third quarters of 2016. These reports will analyze key market developments, providing risk indicators and commentary on issues relevant to investor protection, market integrity and financial stability.

Quarterly Risk Dashboards will present updates on key risk metrics and market incidences.

ESMA will continue analyzing short selling activities, settlement failures and other market activities for which it collects data.

ESMA seeks to establish a centralized data framework by 2017, providing core data management and statistical services in order to obtain horizontal synergies. It will concentrate on dataset cleaning, reconciliation and maintenance, focusing on efficient data management and advanced tools for statistical analysis.

In the first quarter of 2016, ESMA will establish a framework and methodology for product intervention and will identify key areas for policy or supervisory action.

Supervisory Convergence

The promotion of supervisory convergence should create a level playing field in Europe for the benefit of the financial markets at large, including financial institutions, other market players, investors and consumers.

Supervisory Convergence Tools

As mandated under MiFID II, ESMA will finalize new guidelines by the third quarter of 2016. It will prepare Q&As on various topics – including product governance – in the first half of next year and will follow-up on peer reviews on best execution and client marketing prior to the end of the third quarter. In addition, ESMA will evaluate whether updates are required to its original guidelines following the implementation of the MiFID II package and recent peer reviews and thematic studies.

Prior to July 3, 2016 – the date the Market Abuse Regulation (MAR) becomes effective – ESMA must prepare three sets of guidelines as mandated under the regulation. It will also develop guidelines to adapt the existing Market Abuse Directive guidance and prepare Q&As.

In the asset management sector, ESMA will work to establish common supervisory priorities for NCAs. ESMA anticipates further guidelines, opinions and Q&As under the UCITS Directive and AIFMD (including guidelines for asset segregation under AIFM). It will follow-up and conduct additional thematic exercises to facilitate increased supervisory convergence in relation to the Prospectus and Transparency Directive.

ESMA will hold confidential workshops to allow NCAs to share best practices on supervisory procedures.

During the course of 2016, ESMA will deliver two peer reviews as part of its ongoing program on the application of E.U. securities legislation. These will be targeted reviews, backed by onsite visits.

Additionally, ESMA will develop a template for third-country Memoranda of Understanding (MoUs) in the context of the MAR and will draft and negotiate MoUs behalf of NCAs.

ESMA will work within the European Supervisory Authorities' Joint Committee, which will focus its efforts on the areas of consumer protection, cross-sectoral risk assessment and regulatory work. Generally, ESMA will assess third-country equivalence; provide advice and opinions to the Commission and E.U. institutions; cooperate with the Single Supervisory Mechanism; and cooperate with international organizations and third-country regulatory authorities concerning the provision of investment services by third-country firms, credit ratings and trade repository regulatory issues.

Thematic Work

The Credit Ratings Data Reporting System (RADAR) – including the new public interface for the European Rating Platform and a new internal fees database – are scheduled to go-live in 2016.

The Program sets out the following key deliverables relating to supervisory convergence on EMIR:

- annual report on penalties imposed by NCAs;
- E.U.-wide stress test for CCPs and the formulation of recommendations based thereon;
- peer review of CCPs under EMIR;
- validation of CCP risk model changes;
- annual peer review analysis on the authorization and the supervision of CCPs; and
- annual peer review of entities included on the pension schemes.

Additionally, common issues identified in colleges of E.U. CCPs will aid ESMA in formulating its priorities in the area of EMIR convergence.

ESMA will contribute to any requests for advice or information in the context of the Commission's review of the Prospectus Directive.

During the course of 2016, ESMA will work with NCAs to monitor the application of the Transparency Directive, focusing on the use of standard forms and other tools for consistent application of notification requirements under the directive. In addition, it will maintain an indicative list of financial instruments subject to notification requirements under the Transparency Directive.

In the first quarter of 2016, ESMA will finalize its review of best practice principles in the proxy industry. It will provide input on corporate governance issues, including the mapping of disclosure of directors' remuneration.

Next year, ESMA intends to strengthen supervisory convergence in financial reporting, by monitoring the implementation of its enforcement guidelines and its guidelines on Alternative Performance Measures, working with national supervisors to ensure consistent implementation. It will issue a statement on European common enforcement priorities, highlighting topics significant for European issuers when preparing their 2016 year-end financial statements. ESMA will issue reports and extracts of decisions stemming from the European Enforcers Coordination Sessions. ESMA plans to intensify its cooperation with the European Central Bank.

Third Country Relations

In accordance with AIFMD, ESMA will issue advice when called upon to NCAs in relation to the assessment of the Member State of reference of an AIFM and applications for exemption from AIFMD provisions.

ESMA expects several third-country CCPs to be recognized under EMIR in 2016 and therefore intends to work with third-country supervisors to ensure that such CCPs do not expose European clearing members to undue risks.

With regard to the investment activities by third-country firms in Europe, prior to the end of 2016, ESMA will establish the first batch of cooperation agreements with competent authorities of third countries whose supervisory frameworks have been recognized by the Commission as effectively equivalent in accordance with MiFIR. ESMA will also maintain a register of third-country firms authorized to provide investment services in the E.U.

Direct Supervision of Specific Financial Entities

At the end of 2015, ESMA will effect an internal reorganization to establish teams for direct supervision in the two areas of CRAs and trade repositories. Direct supervision of CRAs will involve assessing applications for CRA registration; supervising registered entities; conducting perimeter assessments to identify entities operating without registered status; performing thematic and individual reviews of CRAs; publicly reporting outcomes where appropriate; and proposing enforcement actions.

The RADAR system described above will support ESMA in its supervision of CRAs. ESMA will monitor periodic information and data provided by CRAs as well as overall market dynamics, conducting data analytics as well as engaging with CRAs and other external stakeholders. It will target its supervisory resources to the areas where the greatest risks are identified.

During the course of 2016, ESMA will define an annual supervisory work program for trade repositories, to ensure ongoing compliance with EMIR's requirements.

Finally, ESMA will maintain a general enforcement function, where necessary taking appropriate enforcement action (e.g., issuing public notices, withdrawing registrations or imposing fines) upon the discovery of breaches of regulations in supervised activities.

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