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Internal Market and Services DG

FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS  
**Securities markets**

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**Subject: Supervision of branches under MiFID**

### **I. The issue under discussion**

1. During the last few months DG MARKT services have consulted thoroughly with Member States and regulators on the issue of the allocation of responsibilities among competent authorities with respect to the supervision of branches in the context of Art. 32(7) of Directive 2004/39/EC on Markets in Financial Instruments (hereinafter "MiFID").

### **II. General legal analysis**

2. According to Article 5 of MiFID, an investment firm which wishes to perform one or more investment services and activities listed in Annex I to MiFID must obtain authorisation with appropriate scope by the competent authority of its home Member State. If a firm wishes to provide those same services in another Member State on a cross-border basis or through a branch it can do so under this authorisation. It must simply notify its intention to its home Member State competent authority (Articles 31(2) and 32(2) of MiFID). The home competent authority must then communicate this information to the competent authority of the host Member State, i.e. the State where the firm intends to provide services or establish the branch (Articles 31(3) and 32(3) of MiFID).

3. Read together, these provisions lead to four basic conclusions:

1) Operation on a cross-border basis does not alter the nature of the authorisation granted to the investment firm by its home competent authority, nor does it require that authorisation to be amended: i.e. the MiFID confers a single passport based on home State control. Nevertheless, the MiFID does require the notification of cross-border operations. This notification process is a practical tool for enabling both the efficient supervision by the home competent authority and the effective cooperation among the authorities of home and host Member States.

2) Authorisation under the MiFID is granted to the investment firm as a whole and not to a branch. The establishment of a branch is one of the ways in which a firm can operate cross-border. The branch is an integral part of the investment firm: it is not legally separate and does not require a separate authorisation (Article 32(1) of MiFID).

3) The competent authority that must be notified whenever a company is seeking to provide a service on a cross-border basis or establish a branch in another Member State

is always that of the home Member State. **The MiFID does not provide any role for the host competent authority in the authorisation process<sup>1</sup>.**

4) Any cross-border operation through a branch outside the territory of the Member State in which this branch is located is a provision of services **by the investment firm and not by the branch as a separate legal entity.**

4. By contrast, at the **level of supervision**, the MiFID contains limited exceptions to the principle of home State control. The important exception for the purposes of this paper is set out in Article 32(7) and applies to the supervision of branches with respect to the obligations set out in Articles 19, 21, 22, 25, 27 and 28. In addition, Article 32 (8) confers the power to the home competent authority of the firm to carry out on site inspections in the territory of the host Member State<sup>2</sup>. Some further exceptions to home country supervision under MiFID include the precautionary measures that may be taken by the host Member States (Article 62); the powers for Member States to require all investment firms with branches within their territories to report to them periodically on the activities of those branches for statistical purposes (Article 61(1)); and the power for host Members States to require branches to provide the information necessary to monitor compliance with Article 32(7) (Article 61(2)).

5. These exceptions from the general principle of home State control only concern branches, and do not apply to subsidiaries set up by EU companies in another EU Member State. This is because, unlike a branch which is part of the investment firm, subsidiaries are independent legal entities requiring separate authorisation by the competent authority of their own home Member State in accordance with Article 5 of MiFID.

6. In those cases where Article 32(7) allocates responsibility for supervision to the host Member State (e.g. conduct of business rules), it is logical that supervision should take place on the basis of the host Member State's regulatory provisions transposing the Directive. Conversely, in all other cases supervision should take place on the basis of the home Member State's regulatory provisions.

7. The issue of allocation of responsibilities between the competent authorities of the home and the host Member State is, to a large extent, not relevant with respect to supervision of a large portion of wholesale business. The obligations under Articles 19, 21 and 22(1) of MiFID (art. 24 of MiFID) do not apply in relation to eligible counterparties<sup>3</sup>. So de facto and de jure for those branches which are dealing with eligible counterparties only the obligations set out in Articles 22 (2), 25, 27 and 28 are of relevance. In addition, Articles 22 (2), 27 and 28 of the MiFID have been supplemented

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<sup>1</sup> The only case where MiFID provides for the involvement of competent authorities other than that of the home Member State with respect to the authorization process is in cases where the entity seeking authorization is a subsidiary or under the control of an investment firm or credit authorization authorized in another Member State. In such cases, Article 60 requires the competent authority of the home State to consult other authorities before granting authorities.

<sup>2</sup> Practically speaking all these articles seem to imply that there needs to be cooperation among competent authorities.

<sup>3</sup> In addition, Article 50 of the Implementing Directive 2006/73/EC allows most professional clients to opt for an eligible counterparty status. However, art. 24 (2) second subparagraph also allows eligible counterparties to ask for a "full MiFID treatment". In those cases, the issue of allocation of responsibility is exactly the same as for professional and retail clients.

by detailed implementing measures in the level 2 Regulation<sup>4</sup> which aim at ensuring uniform application throughout the EU. As to transaction reporting (art. 25), CESR has reached an agreement for branch transaction reporting that solves the problem of supervision for all categories of clients (i.e. eligible counterparties as well as professional and retail clients) – see below under III. 8. c)).

### III. Home/host supervision: Different possibilities

8. Following several rounds of consultations with Member States and taking into consideration the background surrounding negotiations on Article 32 (7) of MiFID, the following situations can be envisaged concerning allocation of responsibilities between home and host competent authorities:

a) When both the branch through which the service is provided and the client are in the host Member State, responsibility for supervising the obligations referred to in Article 32 (7) should be allocated to the host competent authority<sup>5</sup>.

b) When the client is in the Member State of the head office (i.e. the home Member State), the competent authority responsible for supervising these same obligations should be that of the home Member State.

c) In between the situations described under a) and b) – where there seems to be consensus on the allocation of responsibility between home and host competent authorities – there is a "grey area" where the allocation of responsibility has to be decided on a case by case basis. This "grey area" concerns cases where the client is not either in the Member State of the branch or in the Member State of the head office. A clear line is even more difficult to draw in those cases where a service, or parts of the service, is carried out in one place, another part in another, through electronic means, outsourcing etc. This grey area has been resolved in the field of transaction reporting (art. 25), where a practical solution has been agreed by regulators within CESR that allows branches to report all their transactions to the host authority and under host provisions if they so wish, with an option to firms to make dual reports to home and host if they so wish. In a case of disagreement concerning the allocation of responsibilities, the Member States concerned should consider using the CESR mediation mechanism. Finally, in those cases where neither the home nor the host Member State competent authority claims responsibility, responsibility should rest with the home Member State supervisor.

9. With the exception of the wholesale area as explained above due to the eligible counterparty regime, it is clear that dual supervision of branches is a reality (the same branch is subject to supervision by two different competent authorities depending on the location of the client). This creates a problem for firms that needs to be dealt with.

### IV. Suggested approach

10. Without prejudice to the issue of legal responsibility, as a practical solution to this complex issue DG MARKT would propose the following **four common principles for the supervision of branches**:

1) Article 32(7) is a derogation to the general principle of home country supervision. In order to allow for an effective supervision by regulators while avoiding unnecessary

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<sup>4</sup> Articles 22 to 34 of Regulation N° 1287/2006

<sup>5</sup> Of course, some tasks or "back office" activities, which are not perceived by the client as part of the provision of the service could take place in a Member State which is different from the Member State of the branch (this could be either the home Member State or a third Member State).

burden for firms there should be effective **shared and cooperative supervision** of the branches between the home and host competent authorities. Such shared supervision would be based on Articles 32(7) and (8), 61(2) and, provided that the necessary conditions are met, 62(2) of the MiFID. In this context, taking into account the allocation of supervisory competences as laid down in Article 32 of the MiFID, both the host and the home Member State competent authorities should take all reasonable steps to support each other fully in the discharge of their respective supervisory duties.

2) DG MARKET considers that home and host supervisory authorities have a **legal obligation to co-operate**. Such an obligation should be based on the following articles:

- a) Article 56(1) which imposes a general obligation for competent authorities from different Member States to co-operate with each other whenever necessary for the purpose of carrying out their duties.
- b) Article 57 which deals with the cooperation of competent authorities for supervisory activities, on-the-spot verifications or investigations.
- c) Article 58(1) which imposes an obligation on competent authorities to exchange information.

3) Competent authorities should establish **Memoranda of Understanding** (MoUs) to determine the practical arrangements for their co-operation in the supervision of branches. Such arrangements would indicate how supervision would be shared between the home and the host competent authority; provide information on any delegation of tasks between home and host competent authorities and inform firms about the applicable law (e.g. conduct of business rules). MoUs should acknowledge firms' needs as regards legal certainty and competent authorities should seek at all times to avoid imposing disproportionate supervisory burdens on firms. In particular, reflecting the harmonising nature of MiFID, competent authorities should seek at all times to avoid imposing disproportionate, duplicative or overlapping supervisory burdens on firms. In order to ensure adequate protection of investors, MoUs should also clearly determine which competent authority would be competent for receiving complaints from investors in particular cases and imposing sanctions.

4) To ensure a level playing field across the EU and the convergence in supervisory practices, the Committee of European Securities Regulators (CESR) should begin work immediately on a **Multilateral MoU for the supervision of branches under MiFID or establish a common template for bilateral MoUs** on the supervision of branches under MiFID. Such a template would be the reference for any particular MoU between competent authorities for the supervision of branches.