European Securities and Markets Authority

The Chair

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ESMA03-173-194

Vice-President Valdis Dombrovskis
Euro and Social Dialogue and in charge of
Financial Stability, Financial Services and the Capital Markets Union
European Commission
Rue de la Loi I/Wetstraat 200
B - 1049 Brussels

Ref: ESMA response to the public consultation on the operations of the European Supervisory Authorities

Dear Vice-President Dombrovskis,

We would like to thank you for the opportunity to share our views on the operations of the European Supervisory Authorities (ESAs) and the effectiveness of the Regulations by which the ESAs are established. We particularly focus in this response on ESMA.

The establishment of ESMA in 2011 was an important step in responding to risks in the EU financial markets and to implement the necessary regulatory reform in response to the financial crisis. Since then ESMA has built a strong track record in the four main areas of activity under its mandate: the single rule book, the direct supervision of some specific entities, supervisory convergence, and risk analysis.

The review of the operations of the ESAs is an important milestone, allowing us to take into account the experience of the past six years and the objectives of the Capital Markets Union (CMU) to establish an integrated EU capital market and to increase the role of financial markets in our economy. Additionally, the review allows us to take into account that the UK will leave the EU, which reinforces the need to build the CMU and it increases the importance of third country issues for European financial markets.

Unique to the EU is the integration of financial markets, where market participants have extensive freedoms to decide where to locate their activities, and to offer services from countries as they see fit for their business. These freedoms are important cornerstones of the CMU and require consistent regulation and supervision. The EU can only fully benefit from the CMU when it further removes barriers within the EU financial markets and adequately addresses the risks related to cross-border activity.

The current supervisory architecture combines centralised tasks within ESMA (regulation and direct supervision of some specific entities), with most of the supervision being done on a national level. It is desirable to continue with this mixed approach, but with a clear view to addressing the risks and opportunities that come along with a more important role for (cross-border) financial markets in the context of the CMU and with the UK leaving the EU. It will be important to find a new balance to foster the single market, reduce barriers, and avoid regulatory and supervisory arbitrage among jurisdictions. Successful European capital markets require a strengthened EU framework that:

- ensures that regulatory and supervisory outcomes for investors and other market participants are consistent across the EU;
- enables the adequate and efficient handling of cross-border risks (intra-EU and between the EU and third countries); and
- respects the principles of subsidiarity and proportionality.

Based on the experience within the current legal framework, and following discussions within the Board of Supervisors, we set forth some recommendations in the annex that we believe will improve the functioning of ESMA and help achieve the objectives of investor protection, and stable and orderly EU financial markets. While acknowledging that the review covers a broad range of issues, the recommendations in this response only address some of the issues in the consultation paper.

We stand ready to discuss with the European Commission the content of this letter and any proposals that may come forward as a result of the review.

Yours sincerely,

(signed)

Steven Maijoor

Annex

I. International aspects of EU financial markets

The European Commission has a leading role in international relations and the applicable EU process governing third country regimes. ESMA welcomes regular dialogue with the Commission on international bilateral and multilateral issues, especially regarding standard-setting activities affecting ESMA's remit.

ESMA stands ready to play a key role in third country issues, as it has the technical expertise to provide support to the legislative and policy processes. ESMA should be the central point for technical third country related issues, including (more regular) equivalence assessments, and ongoing monitoring of regulatory and supervisory developments in the third country.

The current third country regimes generally rely, under certain conditions, on third country regulators. To better respond to risks that third country entities present to EU financial markets, and to ensure consistent supervision, certain third country entities should be subject to regular supervision and enforcement regimes. To ensure a common approach to third country entities active across the EU financial markets, the supervisory and enforcement powers should be conducted at EU level by ESMA for third country entities such as: Credit Rating Agencies (CRAs), Trade Repositories (TRs), Central Counterparties (CCPs) and benchmarks. In the absence of uniform third country regimes for trading venues in the EU, and considering how Brexit may affect the third country approach for data providers, it could also be considered to have a similar role for ESMA regarding these third country entities. Subsequent to this letter, ESMA intends to submit to the Commission an opinion with its more detailed views on improvements for EU third country regimes for financial markets.

II. Direct Supervision

In a relatively short timeframe, ESMA, as the single supervisor for CRAs and TRs in the EU, has become a credible and effective supervisor. It has adopted a well-established risk-based approach to supervision, and implemented effective mechanisms to deal with possible infringements.

ESMA is uniquely positioned to develop a European approach that could have strong benefits for the supervision of pan-European market participants. ESMA stands ready to assume any new supervisory tasks should they be assigned to ESMA, provided that such new tasks are complemented with the allocation of appropriate resources.

The following criteria, which should be considered collectively, could be used to decide whether or not the authorisation and supervision of entities should be done on a EU level:

1. Strong cross-border angle;

2. High risk of regulatory arbitrage;
3. Availability of and ability to pool technical expertise at EU level (instead of building up expertise in multiple member states); and
4. Efficiency gains for EU/national public authorities and/or market participants (which would otherwise face fragmented markets and barriers/duplication).

ESMA currently participates in colleges of supervisors where key decisions are taken in relation to Critical Benchmarks[1]. However, given their cross-EU character and impact and the need for efficient decision-making and consistent treatment of Critical Benchmarks, it would be logical to move supervision of these entities to ESMA. For Data providers[2], MIFID II introduces new requirements regarding authorisation and ongoing supervision. Similarly, the cross-border nature of the services these entities provide, and the fact that they are largely unregulated at national level currently, could merit a centralised supervisory approach by ESMA. Furthermore, the third country entities outlined in Section I should also be subject to direct supervision by ESMA.

While acknowledging the divergent views of Board members with regard to the most suitable approach for supervision of CCPs in the EU, given the cross-border nature of their activities and their systemic importance, ESMA believes that further consideration should be given to ensuring the consistent and effective supervision of CCPs in the EU. In particular, the cross-border dimension of CCP activity indicates that pooled expertise at EU level could allow for more consistent and effective supervision. The key role that CCPs play in the EU warrants the strengthening and potentially centralisation of the supervisory framework, complemented by a role for the central banks of issue, and supported by a viable recovery and resolution mechanism. Such enhancements will help overcome any potential fragmentation of the EU regulatory framework and will support the development of a deeper and more integrated CMU.

Finally, ESMA needs to have the power to impose higher fines on the existing supervised entities (CRAs and TRs), in order to support the credibility of ESMA's enforcement work.

[1] A benchmark is considered as being a critical benchmark where it is used directly or indirectly within a combination of benchmarks as a reference for financial instruments or financial contracts or for measuring the performance of investment funds, having a total value of at least EUR 500 billion on the basis of all the range of maturities or tenors of the benchmark, where applicable.

[2] Data Providers capture Approved Publication Arrangements (APA), Consolidated Tape Providers (CTP), and Approved Reporting Mechanisms (ARM). An APA is a person authorised under MiFIDII to provide the service of publishing trade reports on behalf of investment firms. A CTP is a person authorised under MiFIDII to provide the service of collecting trade reports for certain financial instruments from regulated markets, multilateral trading facilities, organised trading facilities and APAs and consolidating them into a continuous electronic live data stream providing price and volume data per financial instrument. An ARM is a person authorised under MiFIDII to provide the service of reporting details of transactions to competent authorities or to ESMA on behalf of investment firms.

III. Supervisory convergence

The current set of instruments, such as guidelines, opinions, and Q&As, have proven to be useful tools in achieving supervisory convergence. In addition, the use of colleges plays an important role in creating a more common supervisory culture for cross-border entities. ESMA is currently involved in the colleges for CCPs and critical benchmarks and believes the use of colleges could be further expanded in certain areas (e.g. CSDs).

While ESMA has extensively used various convergence measures, its powers and instruments are not sufficiently strong to deal with all cases of regulatory or supervisory arbitrage. It will be key for ESMA to have a strong role in ensuring consistent authorisation scrutiny and supervisory outcomes, avoiding a race to the bottom with the associated risks to investor protection and stability. This is especially important in the context of cross-border activities, and hence for the success of the CMU. While respecting that authorisation and supervision should continue to be conducted at national level for the vast majority of supervised entities, convergence measures should be considered in the case of cross-border authorisations (for example in the areas of MiFID, UCITS and AIFMD) to ensure that national decisions are consistent across the EU.

ESMA is committed to using existing convergence measures as much as possible to ensure consistent and effective implementation and application of rules in the EU. However, given the importance of the supervisory convergence work in the coming years, consideration should also be given to the enhancement of these tools to address future challenges. This is especially relevant regarding the role of peer reviews, access to information on national supervisory practices, and the use of the Breach of Union Law procedure (see also Section VI below). Such improvements to convergence measures and tools could be incorporated into sectoral legislation.

The European Enforcers Coordination Sessions (EECS) mechanism is an example of a successful coordination platform for enhancing supervisory convergence of financial reporting practices. However, ESMA should be granted powers to ensure that the agreed approach regarding live issues discussed in the EECS is subsequently followed when the decision is taken at the national level. This could be done by bringing the International Financial Reporting Standards (IFRS) under the scope of the Breach of Union Law procedure or some other dedicated procedure to be applied in case an NCA is not following the agreed approach (currently such issue could be remedied only by general peer pressure or through a non-binding opinion).

Finally, we propose to increase ESMA's role in the endorsement process for IFRS by imposing a formal/mandatory requirement for ESMA to provide advice related to the European public good and financial stability to the Commission. In such a case, the European Financial Reporting Advisory Group (EFRAG) could then provide the purely technical advice. This should also allow ESMA to be able to provide its advice formally to the co-legislators in case of disagreement with the EFRAG advice.

IV. Governance

In order to optimise the efficiency of decision-making on certain technical decisions currently taken by the whole Board, ESMA believes that its governance should allow additional opportunities for the Board to delegate such decisions to a specific decision-making panel composed of Board members or to the Chair.

V. Access to data and reporting

ESMA considers it important to ensure that there are no national divergences in the level and quality of information provided to European regulators and to the public. ESMA should have more powers to determine the details of EU reporting to be able to:

- set data reporting standards that would ensure the ability to share/exchange data across the EU in a consistent manner (even when data is collected at national level);
- ensure the consistency of data and reporting standards across sectors/legislations; and
- set detailed reporting and formatting standards in a more efficient way than the current endorsement process for technical standards.

A number of sectoral Regulations impose obligations on NCAs to build major databases. Currently most NCAs have mandated ESMA to develop on their behalf an IT project (in the case of MiFIR), as they believe that a centralised solution is more efficient and leads to more harmonised results. For similar tasks in future pieces of legislations, it is proposed to directly empower ESMA to develop those type of large-scale EU-wide databases and to make the data available to NCAs and the public as necessary.

ESMA is also looking for ways to reduce the cost of reporting for market participants and regulators by streamlining the reporting requirements. One issue is that ESMA is currently not able to use data gathered for a specific purpose in the context of other purposes or activities. For instance, data collected from CRA supervision cannot be used for financial stability issues and ESMA's reporting of Trends, Risks and Vulnerabilities. ESMA needs a legal basis to be able to use all data collected for all of ESMA's objectives (subject to necessary anonymization). Only then would ESMA be able to fully leverage on available data and fulfil its mandate in an efficient manner.

ESMA also believes that European Authorities and NCAs should have mutual access to central databases for data in certain areas, for example, investment fund data. This would allow for existing data to be used more efficiently, and it would reduce duplication of data collection and processing by multiple authorities.

VI. Breach of Union Law

In certain cases, ESMA may use its powers under Article 17 of the ESMA Regulation to determine whether an NCA has breached Union law. Should a breach be identified, it is important to ensure that the problem is rectified effectively. If the NCA concerned does not take the necessary action, there are powers in Article 17(6) for ESMA to address market participants directly where the relevant requirements of the acts referred to in Article 1(2) are directly applicable to capital market participants. As substantial parts of the financial market legislation concern Directives, and not directly applicable Regulations, it would be useful to clarify in the ESMA Regulation that these powers also relate to those provisions of Directives that establish unconditional obligations that are sufficiently clear and precise to be directly effective.

In addition, in order to be able to use the Breach of Union Law as an instrument to enhance supervisory convergence in all areas under ESMA's remit, paragraph 1.2. of the ESMA Regulation could be extended to the areas mentioned in paragraph 1.3. (financial reporting, corporate governance, and auditing).

VII. Single Rulebook

Legislative proposals put forward by the European Commission, which are later agreed with the co-legislators, often task ESMA with providing draft technical standards or guidelines and recommendations, or make provisions for delegated acts on which ESMA is then requested to provide advice. The high level of technical complexity surrounding the development of [draft] technical standards and other legislative tools by ESMA, and the need to conduct cost-benefit analysis, public consultation, co-ordination with other authorities, as well as consult the Securities Markets Stakeholder Group, makes drafting such documents time-consuming.

In order to develop European legislation of the highest quality, ESMA believes that the timetable for Level 2 work deserves more consideration when developing Level 1. In particular, ESMA believes that a time table should be prepared that considers carefully the time necessary to draft Level 2 measures, but also the time it takes to implement such measures effectively. It would also be beneficial if ESMA could provide advice on which level 2 measures are most critical to the operation of Level 1.

Finally, ESMA could benefit from having the possibility to temporarily suspend the application of a particular rule within a specific area of the authority's responsibility. This could be achieved through a mechanism similar to the use of "non-action letters" in certain non-EU jurisdictions. For example, the trading obligations laid out in MiFID II could have detrimental effects in case

of a sudden drop in the liquidity of a product and might require urgent suspension action to ensure orderly markets and financial stability.