European Securities and Markets Authority

The Chair

31 October 2013
ESMA/2013/1561

Michel Barnier
European Commissioner for Internal Markets and Services
European Commission
BERL 12/181
1049 Brussels
Belgium

Review of the European System on Financial Supervision (ESFS)

Dear Commissioner,

We would like to share with you our views on the operation of the European System of Financial Supervision (ESFS) and our proposals for its improvement. We would like to ask you to take these into account in the evaluation of the ESFS you are currently conducting, in line with the Regulations establishing the three European Supervisory Authorities (ESAs).

Since its establishment, ESMA's objectives include responsibility for: creating a single rulebook, supervisory convergence in EU securities law application, supervision of credit rating agencies and trade repositories, investor protection and financial stability in the EU.

Looking at the five areas of responsibility, we concur with the International Monetary Fund (IMF) report of March 2013 that ESMA has performed especially well in connection with the development of the single rulebook and the direct supervision of credit rating agencies.

In the past two and a half year, ESMA has contributed to the EU single rulebook with a large number of draft technical standards, guidelines and technical advice in such areas as over-the-counter (OTC) derivatives with the implementation of EMIR, hedge funds and private equity, short-selling, high frequency trading, Exchange-Traded Funds (ETFs), investment advice and financial and prospectus information. The new powers provided to the ESAs under the ESFS were required to achieve this clear and substantial improvement in the EU single rulebook.

Regarding direct supervision, ESMA has developed an effective supervisory regime, and conducted significant on-site supervisory work on CRAs. ESMA now supervises 22 CRAs, with three new entities registered in the last year. While it will take a substantially longer time to comprehensively conclude on the benefits of EU CRA supervision, there are first signs that EU supervision improves the functioning of credit ratings. We expect to announce in early November 2013 the first registrations of trade repositories. This will see ESMA take on further supervisory responsibility as well as starting the clock for the reporting of derivatives trades.

On stability and crisis management, ESMA has substantially improved its coordination capabilities and data and intelligence gathering on risks in securities markets as for example regularly published in ESMA's *Trends, Risks and Vulnerabilities* Report.

While we have progressed substantially in the areas of investor protection and supervisory convergence, it has not been as significant as we would have hoped. ESMA will therefore step up its role in both areas in the coming period. We will continue to progress in the area of investor protection, however, the finalisation of the legislative steps for the Packaged Retail Investment Products (PRIPs) and MiFID 2 will be essential to support this development.

Concerning supervisory convergence ESMA will launch new activities in the near future to strengthen consistency in supervisory outcomes. To improve the organisation and governance of our convergence work we aim to strengthen our peer review tool with on-site visits targeting topical supervisory matters.

Based on the experience of the last years and following discussions by the Board of Supervisors there are some issues which ESMA would like to bring to your attention in order to consider whether Level 1 legislative proposals (either to the ESMA or to respective sectorial legislation) should be put forward to the European Parliament and the Council of the European Union. We trust that improvements in the areas highlighted can help to further improve the regulation and supervision of European financial markets and we stand ready to discuss and develop any proposals together with the Commission.

ESMA's Budget

Today ESMA is financed through three channels: market levies (particularly credit rating agencies and, in the near future, trade repositories), a subsidy from the European Union and an obligatory contribution from national competent authorities for the supervision of financial markets.

Though those national competent authorities do not question ESMA's need for appropriate resources in order to fulfil its mission, we are concerned that an increasing contribution might pose undue difficulties on both their current and/or future functioning. This would run counter to the reinforcement of securities markets regulation and supervision at both EU and national level as envisaged in the regulatory reform in response to the financial crisis. National authorities are an essential part of the ESFS and need sufficient financing to ensure their important role in supervising the correct implementation of EU legislation.

At the same time the funding of ESMA should guarantee its independence and not create potential undue influence from a single body. ESMA therefore believes that the European Commission should consider:

- Increasing the funding ESMA receives from entities which require ESMA's intervention. Indeed, as set out in our letter dated 29 August 2013 we believe that in line with the contributions received from credit rating agencies and trade repositories, market fees should be feasible if the following principles are met: (i) a particular firm or infrastructure benefits from an administrative act by ESMA (such as authorisation or recognition); (ii) the process is launched at the request or prompting of that firm or infrastructure; (iii) the fee would meet costs that can be reasonably estimated.

  We acknowledge that some activities might already be subject to fees levied by national competent authorities. Particular attention should therefore be paid to the potential overlap with national fee levying powers when assessing feasibility.

- Taking the necessary measures as put forward by the International Monetary Fund (IMF) and supported by the ECON Committee of the European Parliament[1], to finance the European Supervisory Authorities (ESAs) through an independent budget line directly within the Union budget; *and*

— Increasing the Union's share in ESMA's budget in order to allow the development of the Authority. We understand that this would not require any changes to existing legislation.

Securities and Markets Stakeholder Group

The Regulation establishing ESMA also set up a dedicated Securities and Markets Stakeholder Group (SMSG) to help facilitate consultation with stakeholders in areas relevant to the tasks of the Authority. The Group should be composed of 30 members, representing in balanced proportions financial market participants operating in the Union, their employees' representatives as well as consumers. According to current legislation half of the members should either be independent top-ranking academics or represent financial market participants. In order to attract high quality representatives and to endeavour a better representation of consumer representatives by making their voice more influential within the SMSG, ESMA would propose that the Commission considers introducing a minimum number of such representatives in the Regulation.

Consultation during Level 1 negotiations

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 provision 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 available to ESMA, including cost-benefit analyses, public consultation, co-ordination with other authorities as well as consulting the SMSG, 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. More particularly we believe a time table should be prepared together with the ESAs on the time necessary to draft

[1] Most recently supported by the ECON Committee of the European Parliament in its Opinion on the General Budget of the European Union for the financial year 2014 (5 September 2013)

Level 2 measures and that it would be helpful if the ESA could provide advice on which level 2 measures are most critical to the operation of Level 1.

Temporary relief

Recent legislative acts introduced several provisions such as clearing obligations, publication of post-trade information, and reporting to trade repositories that need to be applied simultaneously across markets. Neither ESMA nor national competent authorities have the power to modify or suspend these obligations which are set out in final acts adopted by the European Commission or the co-legislators. However, market circumstances might develop where the application of a well-drafted standard might hamper investor protection, financial stability or the efficient working of financial markets.

Market circumstances can change quickly rendering a product illiquid. If for example, a product is subject to the clearing obligation, counterparties will have to continue clearing this product and central counterparties (CCPs) will absorb the risk (in case of default, an illiquid product will not be unwound and the CCP or the default fund deposited by other clearing members will have to bear the losses).

Some market regulators around the globe have therefore the possibility to suspend temporarily the application of a particular rule if its application could lead to unintended consequences or its application requires guidance or technical specifications that are not yet available (but could be available in the short term), without the application of the relief itself leading to consequences unintended by the law.

Now that the EU is further completing the Single Rulebook we believe that the Commission should consider introducing new tools in those areas where ESMA has a mandate to further harmonise requirements (such as clearing obligations). Such a tool would not be a general power to suspend any obligation but would allow ESMA to suspend certain obligations or to provide further guidance in well-defined situations backed up by specific provisions in sectoral legislation (such as EMIR).

This would obviously not be possible without strong democratic control by the European Parliament and Council of the European Union.

Not having the possibility to temporarily suspend legal obligations or to provide further guidance in urgent situations could in our opinion make the Union more rigid from a regulatory perspective and risks not achieving the investor protection and stability objectives.

Collecting Information

The financial and economic crisis highlights the need for uniform and consistent collection and exchange of data between both national and EU macro- and micro-prudential supervisors ,. The various provisions on collection of information in the ESMA Regulation already contributed to a smoother co-operation between the different EU and national authorities. ESMA would however like to note that the many different practices and approaches across the Union in the collection of data have hampered comparability, making the data exchange or presentation in an aggregated format in some cases (almost) impossible. ESMA believes that the ESAs should be provided with a stronger mandate in their respective legislative acts and with adequate resources allowing for the collection of information and the development of a comprehensive IT function in liaison with national competent authorities in order to ensure further harmonisation of available information across regulatory authorities for example through common definitions.

We trust you will find these proposals helpful and would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority

CC:

- Sharon Bowles (MEP), Chair Committee for Economic and Monetary Affairs, European Parliament
- Rimantas Šadžius, Minister of Finance of the Republic of Lithuania
- Jonathan Faull, Director General Internal Markets and Services