European Commission public consultation on supervisory convergence and the single rulebook. International Bulletin of June 2021.

In response to the 2007 financial crisis, in January 2011 the European Union (EU) created three supervisory authorities for the financial markets, one for each of the three sectors (ESMA for the securities markets, EIOPA for insurance and EBA for banking), which, together with European Systemic Risk Board, make up the European System of Financial Supervision.

ESMA has been tasked with three overriding objectives for its sector – financial stability, investor protection and the proper functioning of the market -, which it carries out through four main activities: risk assessment, supervisory convergence, participation in the creation of a single rulebook and the direct supervision of rating agencies and trade and securitisation repositories.

The legal framework of these Authorities was recently reviewed and from January 2020 onwards, following the changes made to its founding Regulations (the 2019 reform), its competences have been strengthened and even increased, in parallel with improvements in its governance.

On 12 March, the European Commission (EC) published a consultation on supervisory convergence and the single rulebook, within the framework of its new Action Plan for a Capital Markets Union (CMU) of September 2020, for which the response period closed on 21 May.

The objective of this public consultation (PC) is to collect information from the parties involved, including the national competent authorities (NCAs), to carry out a review in the fourth quarter of 2021 on both aspects, and based on the findings, assess the need to either implement measures to strengthen coordination between the NCAs in the area of supervision or give new direct supervisory powers to the European Supervisory Authorities (ESAs). This assessment is very likely to lead to another review of the legal framework applicable to the latter.

The EC also plans to consider different regulatory amendments to address the deficiencies detected in the Wirecard case, particularly in the area of corporate governance, auditing and the supervision of financial reporting.

This article looks at the various topics addressed or put forward in the CP conducted by the EC.

Section One of the CP contains questions for the assessment of the ESAs, particularly after the aforementioned reform.

The section asks respondents to offer their opinions on the impact of the ESAs on the European Union (EU) financial system, specifically in terms of financial stability, the functioning of the internal market, the quality and consistency of supervision, enforcement, international supervisory coordination, consumer and investor protection, financial innovation and sustainable finance, focusing on four main areas: a) supervisory convergence, b) governance, c) direct supervisory powers, and d) its role in terms of systemic risk.

The largest part of the questionnaire refers to supervisory convergence, and this topic is addressed first.

Specifically, the EC asks respondents to rate the efficiency of the different supervisory convergence tools used by the ESAs to achieve this objective – providing opinions to the NCAs, exchanges of information between NCAs, supervisory and reporting standards, training programmes, general reports, peer reviews, Union strategic supervisory priorities, coordination groups, Union supervisory handbooks, monitoring and assessing environmental, social and governance-related risks, emergency powers, investigating breaches of Union law, coordinating actions of NCAs in emergency situations, mediating between NCAs, monitoring the work of supervisory and resolution colleges, the ESA's websites, monitoring market developments, coordination of Union-

wide stress tests, guidelines and recommendations, Q&As, the establishment of a common Union financial data strategy and supervisory statements.

The main difficulty in assessing these mechanisms is that some of them were introduced (e.g. the strategic supervisory priorities and EU supervisory handbook) or amended (e.g. peer review and Q&As) as part of the 2019 reform and therefore there is insufficient experience of their efficiency.

The EC is also seeking a more detailed assessment of the following instruments:

– *No action letters*. Specifically, whether the new mechanism assigned to ESAs following the 2019 reform is fit for purpose. It is important to point out that these letters can be addressed to the NCAs and the EC, when in exceptional circumstances they consider that the application of regulatory provisions could cause material problems as they are in direct conflict with other acts or if there are no implementing acts or guidelines, which would raise practical difficulties concerning their application, or even when the application of the rules could cause material exceptional problems relating to market confidence, investor protection, the orderly functioning and integrity of financial markets and commodities markets, or the stability of the whole or part of the EU's financial system, bringing up the problem and at the same time putting forward regulatory proposals or establishing guidelines.

– *Peer reviews*. Specifically, rating their efficiency following the changes introduced in the 2019 reform. The most significant changes introduced in the reform were as follows: a) ad hoc peer review committees composed of ESA and NCA staff, and chaired by the ESA, are responsible for preparing peer review reports; b) the final reports are now adopted by written procedure on non-objection basis; c) if the main findings of the final report differ from those of the committee, dissenting views should be transmitted to the institutions; d) the possibility of addressing recommendations to the NCAs, explaining why they are not complied with; e) mandatory follow-ups to peer reviews within two years after the adoption of the peer review report; and f) the Board is consulted in order to maintain consistency with other peer review reports. The 2019 reform also included the possibility of fast track peer reviews.

– *Breach of EU law and mediation procedures*. Specifically, whether the ESAs have made adequate use of these powers.

– *Emergency situations*. Specifically, whether the ESAs responded correctly to the pandemic caused by COVID-19 and whether a review of the article regulating this power in the ESAs Regulation should be amended.

– *Coordination function*. Specifically, whether the scope of this function is sufficient, even if it has to be carried out by ESAs in the area of outsourcing, delegation and risk transfer arrangements in third countries. It should be noted that after the 2019 review, ESAs can set up coordination groups for specific issues in response to certain market developments. The Commission also seeks opinions on the coordinating role that can be played by ESMA in regard to orders, transactions and activities that have significant cross-border implications.

– *Consumer protection*. Specifically, an assessment of the ESAs' activities in this area and whether any changes should be made in regard to their product intervention powers. The 2019 reform introduced material changes in this area, mainly in the form of new mandates for ESAs such as coordinating mystery shopping, developing risk indicators for retail customers and analysing consumer trends, among others.

– *International relations*. Specifically, whether the role of ESAs in this area is well-designed or should be reviewed. The 2019 reform gave material new competences to ESAs in terms of how they help the EC to prepare equivalence decisions for the supervisory or regulatory regimes of third countries, follow up and report to the European Parliament, Council and Commission on the regulatory, supervisory and market developments of third countries considered to be equivalent or an increased participation of these authorities in international forums.

– *Enforcement*. Specifically, whether the wording of Articles 17 (breach of Union law), 18 (action in emergency situations) and 19 (settlement of disagreements between NCAs in cross-border situations) should be improved so that ESAs can ensure that NCAs, and they themselves if necessary, can require a market participant or financial institution to comply with EU law. The Commission also seeks views on whether the enforcement framework contained in the sector regulations is proportionate and sufficiently dissuasive.

Secondly, the PC addresses the governance of ESAs.

The Commission initially asks for respondents' opinions on the independence of the ESAs. Specifically, it asks about the efficiency of two important guarantees introduced after the 2019 reform: (a) the requirement that the

Board of Supervisors members must abstain from participating in the discussion and voting in relation to any items of the agenda for which they have an interest that might be considered prejudicial to their independence; and (b) the requirement to submit to the European Parliament minutes of the meetings of the Board of Supervisors.

The EC also seeks opinions on whether the ESAs' decision-making process is adequate. The respondents are therefore asked their views on the following points:

– *Chair*. Specifically, on the new powers given to the chairpersons of ESAs after the 2019 reform, strengthening their role. These include requesting the Board to establish internal committees for specific tasks, setting the agenda to be adopted in board meetings, calling votes on specific matters at any time, proposing the composition of independent panels for breach of Union law investigations and dispute settlements, proposing the composition of peer review committees for peer reviews, proposing decisions to launch an inquiry and convene an independent panel for certain investigations, and voting at meetings of the Board of Supervisors (except on matters that are decided on the basis of qualified majority voting).

– *Council*. Specifically, in relation to the efficiency of the new competences attributed to it after the 2019 review, such as giving opinions or making proposals on all matters to be decided by the Board of Supervisors, ensuring the consistent use of a methodology for all peer reviews conducted, proposing a peer review work plan every two years or setting up coordination groups.

– *Board of Supervisors and the voting modalities*. Specifically, whether the new non objection procedure for the implementation of certain decisions, such as breaches of Union law, dispute settlements and peer reviews, is effective for achieving its objective.

– *Composition of the Board of Supervisors and the Board and distribution of competences between them*.

This section also addresses the financing and resources of ESA, stakeholders' group, the Proportionality Committee and the Joint Committee.

Thirdly, the PC asks respondents to assess the direct supervisory powers attributed to ESMA. As mentioned earlier, this Authority has the authorisation and supervisory powers over rating agencies and trade and securitisation repositories. However, from 2022 onwards, ESMA will also be responsible for the supervision of critical benchmark in the EU and their administrators, in addition to the authorisation and supervision of data reporting service providers. It will also be responsible for recognising the benchmark of third countries.

The EC also seeks views on the principles on which the assignment of direct supervisory powers to this and the other two ESAs should be based, and whether any other areas should be included under their supervision.

Fourthly, the PC asks respondents to assess the role played by the ESAs in regard to systemic risk, in particular, their views on the analysis of market developments, the quality of stress tests, the interaction between the ESRB and ESAs on the development of a common set of indicators to identify and measure systemic risk, cooperation within the European System of Financial Supervision and the facilitation of dialogue between micro- and macro-supervisors.

Section Two asks general questions about the single rulebook, such as whether respondents can identify any areas that require greater harmonisation or the degree of detail of the different regulatory levels, in addition to asking respondents to assess the role of the ESAs in this respect, e.g. whether the technical standards and guidelines have contributed to the harmonisation of the standards or whether stakeholders' opinions have been sufficiently collated.

The EC also sets out possible regulatory amendments in the area of financial reporting and auditing, in response to the weaknesses detected in the Wirecard case. This international German electronic payments company had to declare insolvency in June 2020, which revealed a substantial fraud. The company announced that €1.9 billion were missing from an account it held with OCBC bank in Singapore (escrow account).

The following questions have been raised: (a) in general, how can the supervision of auditing and financial reporting be improved; (b) whether ESMA's role in the Transparency Directive should be strengthened, e.g. through a mandate to draw up technical standards to harmonise the enforcement of financial and non-financial reporting, or whether ESMA should annually report on the supervision and enforcement of financial and non-financial information in the EU on the basis of data provided by the NCAs regarding their supervisory and enforcement activities; and (c) whether ESMA should have a role with regard to audit regulations.

Useful link:

Targeted consultation on the supervisory convergence and the single rule book. Taking stock of the framework for supervising European capital markets, banks, insurers and pension funds