

Proposal of the European Commission on the Review of the European System of Financial Supervision. February 2018.

On 20 September 2017, the European Commission (EC) published a regulatory initiative with the intention of strengthening the European financial supervision framework in order to achieve a greater level of integration of financial markets across the European Union (EU). The proposal entails a *reform of the European System of Financial Supervision*, created as a result of the last major financial crisis, and it focuses on the following lines of action: enhancing supervisory convergence, extending direct supervision of the European Union (EU) to some areas of capital markets, changes in the governance and funding of the European Supervisory Authorities (ESMA, EBA and EIOPA) and, finally, the addition of new objectives.

The key new aspects proposed by the EC and, in particular, the European Securities and Markets Authority (ESMA) are briefly described below.

Enhancing supervisory convergence

The EC believes that greater financial integration, such as that aimed for with the Capital Markets Union, requires providing the European Supervisory Authorities (ESAs) with new resources aimed at achieving more consistent application and supervision of applicable legislation in all Member States, thus facilitating cross-border activities. Therefore, with the aim of enhancing supervisory convergence, the proposal allocates the following competences to the ESAs:

a) **Strategic Supervisory Plan.** The ESAs will set out their supervisory priorities at an EU level every three years in a “*Strategic Supervisory Plan*”, approved exclusively by their corresponding new Executive Boards, based on which the national competent authorities (NCAs) will be assessed. Furthermore, the competent authorities will be required to include its content in their annual work programmes and submit them to the ESAs by 30 September of each year.

b) **Developing a supervisory handbook.** The ESAs will develop a supervisory handbook for supervision of market participants in the EU. This handbook will set out best practices and high-quality methodologies and processes.

c) **Independent reviews.** Unlike the current peer reviews, independent reviews will be carried out by staff from the ESAs. The reports that are drafted will contain the follow-up measures considered appropriate, which may be in the form of recommendations, guidelines or opinions. In addition, the European authorities may take into account the result of these reviews when drafting the technical standards and guidelines or even address an opinion to the EC if the result of the review reveals the need for greater harmonisation.

d) **Coordination by ESAs of the supervision conducted by national competent authorities with regard to outsourcing, delegation and risk transfer arrangements in third countries.** The ESAs, with the aim of achieving greater convergence, may coordinate the supervisory actions of the NCAs, and even issue an opinion,

in procedures of authorisation, registration and supervision of entities where the business plan includes arrangements for outsourcing, delegating or transferring risk to third countries.

e) **EU-wide stress tests.** The proposal allows for the publication of the results of the individual financial institutions and recognises the right of the ESAs to act on their own initiative providing they inform the European Parliament, Council and the EC. Finally, the proposal assigns this competence exclusively to the Executive Board.

f) **Right of initiative in cases of binding mediation.** The Executive Boards of the ESAs may initiate the dispute resolution procedure based on objective criteria. In addition, the proposal sets out a list of cases in which it should be understood that the NCAs involved have not reached an agreement.

g) **Requests for information from market participants.** The ESAs may request information directly from market participants in the scope of investigations in breach of EU law procedures. With regard to requests for information in general, the ESAs should firstly address the requests to the NCAs and, secondly, to other authorities of the affected country and, finally, to market participants. However, the proposal strengthens the enforceability of this obligation by empowering the ESAs to sanction and impose fines when the market participant fails to provide information.

h) **Assistance to the EC in the preparation of equivalence decisions.** The ESAs shall monitor the evolution of markets of third countries in which the Commission has taken an equivalence decision, as well as their legislative implementation, supervision and compliance. They will also draw up an annual report for the EC on this matter. They will also participate in developing the administrative arrangements' model that the NCAs should conclude with the authorities of third countries.

i) **Extension of product intervention powers to managers of UCITS and alternative investment funds.**

j) **New coordination role in relation to market abuse as a platform for investigation of cross-border activity that shows indications that a breach may have been committed.** When ESAs have grounds to suspect that orders, transactions or any other activity with significant cross-border effects threatens the orderly functioning and integrity of the market, they may recommend that the NCAs involved should initiate an investigation. In addition, any NCA that suspects such activity shall inform ESMA and the latter may recommend that the NCA should act where the suspicious activity is taking place. For these purposes, ESMA will facilitate the sharing of information, for which the proposal recommends that ESMA play a role of "information hub".

k) **Review of the procedures of the ESAs for issuing guidelines and recommendations.** Each initiative must provide a cost-benefit analysis and public consultations must be undertaken, except in exceptional circumstances. In turn, the proposal recognises the right of stakeholder groups to request that the EC should act if at least two thirds of their members consider that the use made of these instruments breaches EU law.

New competences for ESMA in the field of direct supervision

The EC considers that, in some matters, supervisory convergence requires direct supervision by an European authority. Following this line, this proposal allocates the following new competences to ESMA:

a) **Prospectuses:** supervision (scrutiny, approval and notifications of passports) and corresponding sanction capacity, with regard to the following types of prospectuses (including their supplements):

- Prospectuses for non-equity securities traded on a regulated market, or a specific segment thereof, aimed at qualified investors.

- Prospectuses for asset-backed securities

- Prospectuses drawn up by certain specialised issuers (property companies, mineral companies, scientific research-based companies and shipping companies)

- Prospectuses drawn up by third country issuers in accordance with European regulations.

ESMA will also supervise the advertising of these prospectuses.

b) **Harmonised collective investment funds (EuVECA, EuSEF and ELTIF)**: authorisation, registration and supervision of European EuVECA, EuSEF and ELTIF funds, including sanctioning powers.

c) **Central Counterparties**: the proposal of EMIR 2.2 attributes supervisory powers to ESMA with regard to European central counterparties, and with regard to recognition and supervision of those from third countries.

d) **Data reporting service providers and other amendments to the Markets in Financial Instruments Regulation (MiFIR)**:

- Authorisation, supervision and sanctioning of data reporting service providers
- Direct reporting to ESMA of data on financial instruments for transparency calculations
- Transaction reporting directly to ESMA
- Reporting requirements for the Commission on the functioning of the consolidated tape.
- Allocation to ESMA of powers and competences as competent authority (for example, data gathering for supervisory purposes). ESMA may also delegate certain competences to the NCAs, such as on-site inspections.

e) **Critical benchmarks**: the proposal establishes ESMA as the competent authority for critical benchmark administrators and contributors. It also abolishes the colleges of supervisors as it considers that they are no longer necessary. Finally, it entrusts ESMA with the recognition and approval of third country benchmarks, as well as monitoring the equivalence regimes and concluding cooperation agreements with third country supervisors.

Governance and funding

In turn, the EC considers it necessary to provide the ESAs with a solid structure and funding in order to comply with the powers granted to it.

Although the proposal maintains the role of national supervisors when setting the direction of the activities of these Authorities and participating in regulatory decisions, the most noteworthy measure put forward by the EC in the scope of governance is the creation of a new body, the Executive Board, which will replace the current Management Board.

This Board will be comprised of Independent full-time members, which will essentially coordinate the supervisory practices. Its assigned functions include:

- Examining, giving an opinion and making a proposal on all matters to be decided by the Board of Supervisors.
- Proposing, for adoption by the Board of Supervisors, an annual and multi-annual work programme for ESMA.
- Exercising its budgetary powers.
- Acting and adopting decisions in relation to matters of a non-regulatory nature, fundamentally relating to supervision and supervisory convergence. Specifically, the Executive Board will have decision-making powers in breach of EU law procedures, settling disputes between NCAs, the Strategic Supervisory Plan, independent reviews, monitoring outsourcing, delegation and risk transfer to third countries, stress tests and requests for information.
- Appointing and removing members of the Board of Appeal.

With regard to funding, the aim of the EC is to remove the contribution of the NCAs from the funding of the ESAs. Specifically, the proposal suggests that part of the budget should be financed directly by financial institutions by means of annual industry contributions. In order to determine the amount of the contributions, an EC delegated act will set the methodology for assigning the estimated cost of the contributions to each Authority for each one of the different categories of financial institutions and market participants, as well as criteria determining the level of individual contributions, which will be based on size. This is without prejudice

to the collection carried out by the NCAs for which they may use their current collection systems (and the amount of which must be paid to the European Authority by 31 March). A second source of income will be the General Budget of the Union (specifically, at the expense of the Commission), although this may not exceed 40% of the funding. The third most important source of revenue in the case of ESMA will be the fees directly collected from the entities of the EU and third countries supervised by this European Authority. In the scope of securities, ESMA will calculate the individual contributions of each entity and participant and it will therefore need to request prior information from the NCAs. The NCAs will be responsible for preparing the invoices, collecting the contributions and adopting the necessary measures in the event of non-payment.

New objectives

The integration of sustainable finance and financial supervision

The EC considers it essential that the EU should be able to direct private capital towards sustainable investments. Without prejudice to the Strategic Plan in this area, which will be announced at the start of 2018, it entrusts certain powers to the ESAs in this regard, such as monitoring how financial institutions treat environmental, social and governance risks (*ESG risks*), advising on how to better integrate sustainability issues into European regulations and promoting consistent implementation of the provisions to be adopted or identification of environmental, social and governance factors that affect financial sustainability.

Adapting the supervisory structure to take advantage of the potential of FinTech

As in the previous case, although the EC will present an Action Plan at the start of 2018, this proposal entrusts the ESAs with promoting technological knowledge among the NCAs and the exchange of information on cybersecurity, as well as the coordination of different national technological innovation hubs and sandboxes, and adopting guidelines and recommendations.

Macro-prudential supervision

At a macro-potential level, the EC proposes continuing with the President of the European Central Bank as the Chair of the ESRB, strengthening the position of the Secretary and reflecting the Banking Union in its representation (the members of the Single Supervisory Mechanism - SSM - and the members of the Single Resolution Board - SRM - should be represented on the General Board of the ESRB with the right to vote).

Finally, the EC proposal is currently being reviewed by the Council and Parliament of the EU and amendments may be proposed. We will have to wait for the result of these negotiations in order to know the final scope of this legislative amendment, which the EC hopes will enter into force in 2019.

Links of interest:

[Review of the European Securities Authorities](#)