EPFSF Briefing on "The Review of the European System of Financial Supervision (ESAs and ESRB)" 22 May 2018

Introduction

Against the background of the 2007-08 financial crisis and building on the recommendations of Jacques de Larosière High Level Group on EU financial supervision, the European Commission put forward legislative proposals to strengthen financial supervision at the European Level in October 2009. The three European supervisory authorities - the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA), and the European Insurance and Occupational Pensions Authority (EIOPA) - were then established. These authorities were tasked with contributing to the development and application of the single rulebook for financial regulation in the European Economic Area. In addition, and in view of further deepening the integration of the financial sector, the European Commission unveiled its action plan for building a Capital Markets Union in September 2015, stressing the need to enhance both supervisory and regulatory convergence in the EU.

The Commission's 2017 programme announced the review of the European System of Financial Supervisors (ESFS), which includes the three ESAs, and the European Systemic Risk Board (ESRB), which is tasked with monitoring stability risks. The proposals, published at the end of September 2017, were preceded by the Commission's public consultations in autumn 2016 (Review of the EU-macroprudential framework) and spring 2017 (ESAs). Other preceding relevant documents include the March 2014 recommendations of the European Parliament and the August 2014 Commission's review report.

Review of the ESAs: The proposals

Funding

Currently, EBA and EIOPA are funded by contributions from the EU's budget (40%) and the National Competent Authorities (60%). For ESMA, 50% of its funding structure comes from NCAs, around 25% from the EU budget and approximately 25% from direct contributions from entities, which are under its direct oversight (today, only trade repositories and credit rating agencies).

The Commission's proposals suggest introducing a model whereby the ESAs annual budget is partly funded by direct contributions , (though with only a limited increase in entities under direct supervision), replacing the current mandatory contributions from NCAs. The Commission's proposals maintain the current regime that allows the three ESAs to collect fees from entities subject to direct supervision, and proposes to limit the total annual contribution from the EU budget to 40% of the ESAs' annual budget.

ESMA enhanced coordination role and supervisory oversight

Under the Commission's proposals - and in addition to its current oversight of Credit Rating Agencies and Trade Repositories - ESMA would become the direct supervisor of new entities, as follows :

• Direct supervision and authorisation of certain EU-labelled investment funds: ESMA would directly supervise certain type of investment funds, i.e. European Venture Capital Funds (EuVECA), European Social Entrepreneurship Funds (EuSEF), and European Long-term Investment Funds (ELTIF).

• Critical and third-country benchmarks: The Commission proposes meaningful changes to both the designation and procedure of critical benchmarks, as well as designating ESMA as the competent authority. Powers would also be transferred to ESMA regarding the procedures for recognition and approval of critical benchmarks located in a third country that apply for a license to operate in the EU.

• Approval of certain types of prospectuses: ESMA would directly supervise certain categories of prospectus (wholesale non-prospectus, prospectuses for certain complex securities; prospectuses developed by specialised issuers and prospectuses prepared by third-country issuers). ESMA would also be responsible for approving new prospectuses and related advertising as well as having the competence to suspend or restrict and offer of securities to the public or admission to trading on a regulated market.

ESMA coordination role would also be extended to include market abuse investigations, notably through direct intervention or coordination of cross-border investigations. ESMA would, under the Commission's proposal, also be given intervention powers to restrict or prohibit the marketing, sale or distribution of shares/units of UCITS or AIFs.

Cross border delegation arrangements with third countries

Another significant power proposed in the ESA review would be giving the ESAs the ability to scrutinise (and potentially challenge) the NCAs authorisations of individual entities with regard to those firms' delegation, outsourcing, and material risk transfer arrangements to entities domiciled in third countries. Whilst the initial notification and authorisation would remain with the home country national authority, it would have to notify the ESAs on a semi-annual basis of all delegation, outsourcing and material risk transfer that have been approved during the period. In addition to monitoring new authorisation activities, the ESAs would be able to issue recommendations to the national competent authorities (which would be made public if the NCA did not act on them) to review or withdraw authorisations that have been previously granted.

EIOPA: Evaluation of internal models for insurance companies

Whilst the approval of internal models would continue to be granted by national authorities, EIOPA would have the power to issue opinions on individual applications to use or change an internal model. These opinions would be issued two months ahead of the deadline for national authorities to provide their approval and trigger a comply-or-explain mechanism for national authorities.

Governance of the ESAs

Currently, the governance structure of each ESA consists of a Supervisory Board – the main decision-making body of the ESAs, composed of the heads of the 28 national competent authorities and the Chair of the ESA – and a Management Board, which supports the ESA in carrying out its mission and performing the tasks assigned to it. The current Management Board is composed of the Chairperson, a number of representatives of national supervisory authorities and a representative of the European Commission.

The Commission proposal introduces a new independent Executive Board with full-time members, replacing the current Management Board. Their main task would include preparing budgets, multiyear strategic plans for both ESA and NCAs as well the decisions to be taken by the Board of Supervisors. Additionally, it would be entrusted with direct powers over a number of primarily non-regulatory issues, such as breach of Union Law, systemic risk and stress tests, and dispute settlements. The Board of Supervisors would remain the main final decision making body.

The Commission also reinforces the consultative role of each ESA's Stakeholder Group: For instance, the ESAs would be required to carry out cost-benefit analyses when developing recommendations and guidelines. The Stakeholder Group would be tasked with issuing an opinion (when a two-third majority agreement within the Group is reached) where it deems that the ESAs have exceeded its competence. In such scenario, the Commission would assess the opinion of the stakeholder group and would have the power to require the ESA to withdraw the concerned recommendations or guidelines.

Regulatory Forbearance powers

The appropriateness of granting the ESAs with regulatory forbearance powers that could be used when application dates of texts prove unworkable was extensively discussed within the European Commission but is not part of the ESA review legislative proposal. For legal reasons, the European Commission has not introduced proposals on this subject although it was considered a priority by individual industry segments and by national regulators. The topic may however re-merge during the legislative process.

Review of the ESRB

The Commission proposes to enshrine in EU law the current arrangement under which the ESRB is chaired by the ECB president. The Commission also proposes to include the Single Supervisory Mechanism (SSM), and Single Resolution Board (SRM) as voting members of the ESRB General Board, in order to take into account regulatory developments and changes to the macro prudential framework that have occurred since the ESRB was established.

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