ESA review proposal

ECON Committee hearing (27 February 2018)

General comments on the proposal

- The positive role that the ESAs have played in fostering the creation and implementation of common rules for financial services in the EU is widely recognised. In a very short period of time the ESAs have established themselves and are respected by market participants, Member States, the EU institutions and globally for the professional way in which they have undertaken their duties.
- This objective has however only partially been achieved, since the implementation of EU laws is not always consistent across the Union, for example in areas such as investment funds or insurance. In addition new events such as Brexit and initiatives such as the CMU and the Banking Union reinforce the need for common approaches at the EU and Eurozone levels.
- The main thrust of the ESA review proposal, which aims to develop a stronger European dimension of supervision and provide the ESAs with the necessary powers and tools to ensure sufficient supervisory and regulatory convergence within the EU and vis-à-vis equivalent third countries is very relevant in this context.
- The scope of the current ESA review proposal is however quite wide and far-reaching and covers many different aspects of supervision and governance. I would like to highlight three areas which I believe are the most important ones for allowing the ESAs to fully achieve their objectives related to the single rule book and to the preparation and monitoring of equivalence agreements with third-countries.

I - The need to differentiate more explicitly the objectives and roles of the 3 ESAs

- I think that the ESA review recommendations could distinguish more explicitly the three ESAs, as these operate in quite different contexts.
- For EBA we need to take into account the existence of the SSM which in effect handles a large part of direct banking supervision in the EU, since most major European banking groups have their headquarters in the Eurozone. EBA however has a major role to play in the definition of a common rule book at EU level and in negotiating and implementing equivalence decisions with third countries and their banking entities.

- For EIOPA I would see the same type of role as for EBA, mainly focused on the common definition and interpretation of standards and the harmonisation of regulatory requirements across the EU. These tasks indeed often involve detailed technical assessments and calibrations and will benefit from a pooling of resources and competences at the EU level. I am therefore more hesitant about the proposal for EIOPA to authorize internal models, which would lead to splitting the validation of internal models (by EIOPA) and their day-to-day supervision (by the NCAs) which may create some inefficiencies. A better alternative in my view would be to ask EIOPA to ensure the comparability of internal models used across EU insurance companies, while their actual authorisation would remain at the domestic level, and to achieve a common interpretation and a consistent implementation of Solvency II rules.
- For ESMA the situation is somewhat different. In addition to standard setting and supervisory convergence there is more scope for direct supervisory tasks, given the significant cross-border dimension of many capital market activities and the absence of a common supervisory body such as the SSM.

II - Priority should be given to improvements that may support the implementation of a single EU rulebook and equivalence arrangements with third countries:

- The primary objective of the ESAs is to ensure that a single rulebook with detailed regulatory standards for financial services is adopted and implemented at the EU level. At present the ESAs do not have all the necessary powers to achieve this objective, as demonstrated by inconsistencies in the implementation of many regulatory standards across the EU. Therefore I support the recommendations made by the EU Commission to increase the decision-making, arbitration and investigation powers of the ESAs in different areas such as: breaches of Union laws, the settlement of cross-border disagreements and the consistent implementation of EU requirements (e.g. with the possibility for them to conduct independent reviews). The ESAs should also have the possibility to conduct directly investigations when infringements are observed.

  An extension of the supervisory powers of the ESAs would be to provide them with the ability to set data reporting standards related to EU legislations in order to facilitate data consistency and sharing and also to centralise at ESA level the

development and maintenance of related databases and IT systems, as proposed for market abuse rules.

These changes require reviewing and strengthening existing processes and powers of the ESAs.

However I am not sure that a fundamental modification of the governance structure of the ESAs is needed. Instead of creating a new body which would add an extra layer to the system and possible complexity, I would suggest to increase the independence of the existing Management Board, with the addition for instance of two or three independent members coming from academic and corporate circles, particularly to handle conflicts of interest. Moreover I would extend the mandate of the Management Board to issues related to supervisory convergence and possible breaches in the consistent application of EU standards1 which are only addressed at present by the Board of Supervisors, which may create conflicts of interest in some cases. Indeed peer pressure is very often insufficient for tackling such issues. An additional point could be to attribute a casting vote to the Chairperson within the Management Board, as a last resort tool in case of divergence within the Board. In the case breaches or disagreements cannot be solved through the improved governance processes of the ESAs, they should ultimately have the ability, in cooperation with the EU Commission to request arbitration from the European Court of Justice.

- A second key assignment of the ESAs, which is becoming increasingly important with Brexit, is the management of interactions with third countries. The proposal made in the ESA review to entrust the ESAs with the responsibility for monitoring on an on-going basis the regulatory and supervisory practices of third-countries and the delegation arrangements to third-countries by EU entities should be given a high priority in this context. In this perspective it would also be important to preserve the ability in the future for the ESAs to be the platform of European cooperation with non-EU financial centres such as the City to the mutual benefit of both parties.

The final aspect which I will comment on is the direct supervisory powers of the ESAs, which are mainly relevant for ESMA.

[1] *At present the Management Board deals with strategy formulation (for the ESAs), different issues pertaining to the management of the ESAs (i.e. budgetary, IT, HR issues…) and to a lesser extent questions related to the implementation of the single rulebook. In addition the Management Board of ESMA also addresses issues related to the direct supervision role of ESMA.*

III - Focusing direct supervisory powers on cross-border activities where there are strong synergies at EU level

- Increasing the direct supervisory powers of the ESAs and particularly ESMA makes sense in areas where a European approach has a real added value i.e. areas which are highly cross-border and of a wholesale nature2, where strong synergies can be achieved at the ESA level and where domestic supervision may on the contrary lead to inconsistencies, inefficiencies or regulatory arbitrage. Credit rating agencies and trade repositories which are supervised by ESMA both have these cross-border characteristics. I agree with the EU Commission proposal that some other entities such as data providers and administrators of critical benchmarks could also be directly supervised by ESMA, given these criteria. This is also the case for certain Financial Market Infrastructures that have a strong systemic and cross-border dimension for the whole Union, such as CCPs, which would be best monitored at the EU level. I personally support the proposal recently made for ESMA to play a stronger and direct role in the supervision of EU and third country cross-border CCPs with the support of the central banks of issue concerned, which is consistent with this idea. However I believe that the activities related to the supervision of CCPs would be best performed within the existing governance structure of ESMA and should not require the creation of a new entity within ESMA.
- I am also sceptical about extending direct supervision by ESMA to some other areas such as the authorisation of certain fund categories (such as ELTIF and EuVECA) or of certain prospectuses. While it is true that some of these instruments have a cross-border nature, a large part of the authorisation of investment funds and other securities will continue to be performed at the domestic level, meaning that we would have two different authorisation processes for the same category of instrument. In addition some of these instruments (some of these funds) have a retail dimension. Moreover, this would oblige ESMA to build new competencies that may duplicate to a certain extent those that already exist at the domestic level. I am therefore concerned that this may create some complexity and overlaps that may offset the potential benefits of a more centralised approach. I would rather see a role for ESMA in this area in the provision of common tools, such as common product and prospectus databases, which could facilitate the cross-border marketing of these securities by providing investors and issuers with a central point of access to information.

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[2] *Conversely maintaining supervision at the domestic level seems necessary for retail activities which rely on domestic rules and often have specific characteristics e.g. in terms of language.*

- ESMA should nevertheless be able to intervene quickly and in a decisive way if EU fund or management company rules are not appropriately transposed in a given Member State or if any investor protection or financial stability issues are detected regarding specific funds or prospectuses. This should be facilitated by the recent implementation through MiFIR of product intervention powers for ESMA. Moreover, ESMA should have the power to review domestic authorisation and supervisory processes if problems repeatedly happen in a given Member State.

Finally, let me quickly touch upon three last points.

- The first one concerns the budgetary implications of the proposal. I agree with the proposal of the EU Commission, which is to resort to industry financing for 60% of their budget.
- The second point which I would like to briefly mention is the need to review the functioning of the ESRB. The proposals of the EU Commission focus on the management and the governance of the ESRB which are valid topics, however in my view they miss a major point which would be to put the ESRB in a position where it can continuously assess and monitor all vulnerabilities in the EU financial system and notably those related to the monetary policy of the ECB. This would imply in particular reinforcing the independence of the ESRB vis-à-vis the ECB (with the appointment of some eminent experts) and not further integrating it in the functioning of the ECB as is currently proposed (see my previous testimony at the EU Parliament in May 2016).
- The final point which I would like to emphasize, is the urgency of adopting the measures we are discussing today to review the operation of the ESAs. I firmly believe that this proposal, which is essential for further integrating EU financial markets and making progress with the Banking and Capital Markets Unions, should be adopted under the current EU Commission and should not be postponed any longer and certainly not to a possible future crisis. It should be possible with some of the adjustments I have suggested to find a consensus on this proposal in the Council for the benefit of the whole Union.

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