German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments on the proposal of the European Commission for a review of the ESAs' framework

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A. General comments

The German Banking Industry Committee takes note of the review and reform of the European supervisory system comprising EBA, ESMA and EIOPA. Not least because of the probable departure of the United Kingdom, a competitive financial market is of elementary importance for the EU. The review of how efficiently the European supervisory authorities function plays a crucial role in this. In particular, the consistent application of supervisory law among the Member States must be ensured. In enforcing convergence, the European leitmotiv of subsidiarity must be taken into account too. Against this background, in our opinion, the EU Commission's proposal contains appropriate additions to the ESAs' competencies insofar as pan-European issues are concerned, such as the direct supervision of the administrators of critical benchmarks by ESMA. Nevertheless, we consider that the legal basis invoked by the EU Commission from Art. 114 of the Treaty on the Functioning of the European Union (TFEU) for the proposals are not sufficient in all points, particularly with regard to the additional competencies and the planned restructuring of the funding of the ESAs.

Our comments in detail differentiate between the proposals to supplement that affect all ESA regulations and the proposals to amend other individual European regulations. Finally, we deal with aspects in connection with regulations in the ESA review that in our opinion are not mentioned/not adequately mentioned in the proposals.

B. Proposals to supplement additional competencies of the ESAs

I. No super-supervisory authority/ESA as the "supervisors' supervisor":

According to the EU Commission's plans, the ESAs are to be enhanced to a kind of "super-financial supervisory authority". Among other things, they should be empowered to maintain a "supervisory handbook" with best-practices suggestions for the supervision of financial markets players in the EU and (on a triennial basis) a "strategic supervisory plan" that lays down supervisory priorities and should identify "microprudential trends", risks and weaknesses. On this basis, the national supervisory authorities should then submit to the ESAs a draft of their annual plan for the coming year. If, after reviewing it, the ESAs find that the plan is not in line with the provisions of the supervisory plan, then they shall issue to the national supervisory authorities "recommendations" for amendments to the plan that the national supervisory authorities have to incorporate when revising their plans. Besides investor protection, the ESAs should promote consumer protection too.

These proposals should be rejected, as they would mean a de facto first step towards a direct supervision by the ESAs of the national supervisory authorities and thus also an indirect supervision of market participants. The national financial markets and their supervisory structures are very different for good reason. The ESAs are not familiar with each individual market and hence cannot formulate any strategic goals and priorities. Besides, the ESAs do not have the requisite practical experience. It would be "redundant" here to create additional structures alongside the existing (and proven) national supervisory structures.

Finally, the proposals for the supervisory plan are not concrete enough. Still unclear is whether and to what extent national supervisory authorities are involved in its preparation and national particularities of the respective markets taken into account.

II. Additional competencies for ESMA only in moderation: in particular, no powers for ESMA for funds supervision and prospectus scrutiny

The EU Commission proposes an extension of ESMA's direct supervisory powers. In particular, ESMA should become the competent supervisory authority for special(ised) funds companies (ELTIF, EuVECA, EuSEF). ESMA should, furthermore, be tasked with the scrutiny of certain categories of prospectuses. In addition, ESMA should become the competent supervisory authority for certain data reporting services providers and be given competencies for the coordination of market abuse procedures and the determination of "critical benchmarks". ESMA's current powers should, moreover, be extended in area of third-country equivalence examination (and product intervention for certain funds). Additional competencies for ESMA to create common standards in individual areas such as the supervision of administrators of critical benchmarks, the supervision of data reporting services providers and as part of equivalence processes/tests are to be welcomed by virtue of the "pan-European" connection.

In other cases, we see this critically. In particular, we advocate the maintenance of the proven system of prospectus scrutiny and funds supervision by the national supervisory authorities.

Effective supervision is always guaranteed when it is exercised close to the respective market and takes into account the national market conditions/particularities/features. This includes the interplay with (national) civil law. Besides, for prospectus law, this is also reflected in the prospectus regulation that recently came into force. It should be noted moreover, that the majority of securities issues are offered in only one or a few Member States. Here, prospectus scrutiny by the national supervisory authorities can be done on the doorstep, as these authorities are familiar with the particularities of their local markets.

It makes no sense therefore to create completely new structures in these areas and additional resources at ESMA, especially as supervisory convergence is already ensured with the existing instruments (e.g., the carrying out of peer reviews and the issue of guidelines). By these means, potential supervisory arbitrage is already effectively countered.

C. Further proposals concerning additions to all ESMA regulations

I. Additions/amendments of the proposed process to issue Level 3 measures

In future, the ESAs should basically be obliged to conduct open public consultations prior to issuing guidelines and recommendations (cf. Art. 3 para. 7 (b) of the proposal to replace the existing Art. 16 para. 2 of Regulation (EU) No. 1095/2010 (ESMA Regulation)). This approach is to be welcomed as is ESAs' new duty to conduct cost-benefit-analyses. It is unclear, however, under which circumstances a public hearing and a cost-benefit-analysis can be waived ("save in exceptional circumstances"). Clarification is required here.

Additionally, when competencies in the area of Level 3 instruments (guidelines and recommendations) are exceeded, the ESAs' Stakeholder Groups (SGs) should be authorised to consult the Commission with a reasoned opinion (cf. e.g., Art. 3 para. 7 of the proposal (d) to supplement the existing Art. 16 of Regulation (EU) No. 1095/2010 (ESMA Regulation) with a new, additional paragraph). A condition for this should be a two-thirds majority of the SG concerned. If the Commission goes along with SG's evaluation that a competence has been exceeded, then it can require the ESA to withdraw the guideline or recommendation. The Commission's decision shall be made public.

The proposed measures are not sufficient to curb the ESAs' self-mandating. ESMA's modus operandi for the preparation of technical advice for MiFID II serves as an example of cases of self-mandating (Chapter 2.15 of the Final Report – ESMA's Technical Advice to the Commission on MiFID II and MiFIR – ESMA 2014/1569). In this, ESMA draws up complex requirements not covered by Level 1 for the admittance of inducements. A further, topical example is contained in the guidelines proposed by ESMA in its consultation paper "Guidelines on certain aspects of the MiFID II suitability requirements" (ESMA35-43-748) of 13 July 2017 that in the view of the German Banking Industry Committee at various places exceed Level 1- and Level 2-requirements of MIFID II.

Precisely because of the strongly heterogenous composition of the SGs, the proposed two-thirds majority constitutes a too high threshold that in practice would make using the mechanism considerably more difficult. In this regard, a simple majority should suffice. On grounds of transparency, the Commission should furthermore be obliged to justify its decision and to disclose this likewise.

More particularly, however, we view the proposed scrutiny of an executive-authority decision by another executive authority critically. Rather, in such cases, the European Parliament, as a democratically legitimised body, should be involved. This applies particularly to situations in which the ESAs are not legitimised to enact Level 3 measures in a Level 1 or Level 2 legal act. In these cases, the ESAs should notify the European Parliament in advance of their action and give it the opportunity to scrutinise.

In addition, a legal-recourse procedure should be instituted to scrutinise Level 3 measures.
Finally, it holds generally that in the preparation of consultation drafts market participants should already be involved as part of the "drafting process" and not be confronted with a "fait accompli".

II. Governance

The Commission proposes converting the existing ESA Management Boards into so-called Executive Boards that are filled with an ESA chairperson and several full-time members. These together with the ESA chairpersons should in future be appointed by the European Council, which should enhance their significance within the ESAs.

The establishment of Executive Boards with full-time members can indeed make sense. This must not, however, lead to a situation where the national particularities of the Member States and the different supervisory structures, if any, are ignored. The ESAs are authorities backed by the supervisory authorities of the Member States. Against this background, the proposal to set up an Executive Board independent of the representatives of the national authorities is to be viewed critically. Decisions by an Executive Board with independent members on important issues of indirect supervision, such as the Strategic Supervisory Plan or interventions to avert serious negative consequences for the internal market and the real economy (Art. 22 ESA Regulation), should require approval by the Board of Supervisors.

In addition, the size of the financial market concerned should be taken into account during future voting on the Executive Board and on the Board of Supervisors.

There should, furthermore, be provision for Member States that are not affected by a regulatory measure to be excluded from voting on it.

Moreover, with regard to the appointment of the ESMA Stakeholder Group, representation of the different pillars of the banking system (cooperative, private and public) should be factored in. This means, that representatives of all pillars of the banking system should be considered - as is already the case with the EBA Stakeholder Group. In this context, the number of representatives from the industry should be increased.

III. Keeping the existing funding model requires budget discipline

To fund the ESAs, the EU Commission proposes the introduction of contributions to be borne by the industry. According to this, at least 60% of the ESA budget is to be borne by fees from directly and indirectly supervised market participants. The remaining funding requirement of a maximum of 40% should be a balancing contribution from the EU budget. In addition, the possibility of voluntary payments to the ESAs should be created so that national supervisory boards can, for example, execute specific ESA projects.

But we advocate keeping the existing simple and clear funding model (60% national supervisory authorities, 40% EU budget) and are against fee-financing. Only in this way can we avoid massive budget expansions of the ESAs that would be expected with funding through the institutions. Funding the supervisory authorities with a fixed portion of the EU budget ensures budget control and prevents uncontrolled spending. The drafts before us already show also the first expansive effects of the proposed funding with fees: in anticipation of a future participation by the institutions in the ESAs' budgets, the prospect of 220 new posts has already been held out to the ESAs. While it is correct that the supervisory function must be endowed with appropriate resources to carry out its duties, this may at no event lead to a further burden on the institutions. This applies particularly against the background that the ESAs carry out regulatory functions that would otherwise fall under the responsibility of the Commission. In contrast to supervisory activity – such as that by the ECB supervisors – there is no concrete connection to the individual institutions.

We suggest considering the use of secondments from the industry. In this way, practical experience could be accessed for the ESAs, without incurring substantial additional costs.

IV. Direct requests for information by the ESAs

The proposals provide for the ESAs to have direct rights to information from market participants that can be subject to fines of up to EUR 200,000 (cf. Art. 1 para. 20 of the proposal to insert new Art. 35a to 35h in the Regulation (EU) No. 1093/2010 (EBA-Regulation) and Art. 3 para. 21 of the proposal to insert new Art. 35a to 35h in die Regulation (EU) No. 1095/2010 (ESMA Regulation)).

Such requests for information by the ESAs are to be rejected. The penalisation by itself for careless infringements against such requests is not only disproportionate, but there is the latent risk that what are actually subsidiary direct requirements for information will in practice burgeon into a control system and in this respect dilute the proven competencies of the national supervisors.

D. Proposals for changes to Regulation No. 1095/2010 (ESMA Regulation) (Art. 3 of the Commission's proposal)

I. Amendments/additions to the provisions for ESMA's scope of activity

In the proposed Regulation for the ESMA's restructuring, the inclusion of, inter alia, the Accounting Directive 2013/34 in ESMA's scope of activity is put forward (cf. Art. 3 para. 1 (a) of the proposal to replace Art. 1 para. 2 of the Regulation (EU) No. 1095/2010 (ESMA Regulation)). Already in the preceding ESA consultation, a broadening of ESMA's competencies in the areas of accounting and auditing was discussed intensively and rejected by many representatives from the industry.

Against this background, it is unclear which ESMA activities are planned that necessitate a reference to the Accounting Directive 2013/34.

II. Amendment of a coordinator function by ESMA in relation to orders, transactions and activities with significant cross-border effects

In future, ESMA should in relation to the national supervisory authorities carry out a coordinating function for orders, transactions and activities with significant cross-border effects that could endanger the orderly functioning of the financial markets and financial stability. To this end, ESMA should, inter alia, establish a data storage facility (cf. Art. 3 para. 16 of the proposal to insert a new Art. 31b in the Regulation (EU) No. 1095/2010 (ESMA Regulation)).

After an initial assessment, we see the proposal critically. For one, the exact background of this provision is not clear. According to the reason given, this function should be of significance in connection with market abuse (p. 21 of the Commission's proposal). The necessity for an additional competence for ESMA does not follow, however, in view of the wide-ranging duties already foreseen for the national supervisory authorities in Art. 24, 25 Regulation (EU) No. 596/2014 on market abuse (Market Abuse Regulation) in cooperating inter se and with ESMA. The proposed provision, furthermore, contains a large number of indeterminate legal terms without any illustrative examples, so that it is unclear which competencies are ultimately assigned to ESMA/the national supervisory authorities. We fear that this provision could be used by ESMA as a form of "blanket clause" to grab competencies for itself.

E. Proposed changes to the Regulation (EU) No. 600/2014 on markets in financial instruments (Art. 6 of the Commission's proposal)

I. Extension of powers for product intervention

The powers of the national supervisory authorities and ESMA with regard to product intervention under MiFIR should be extended to UCITS, UCITS management companies and AIFM (cf. Art. 6 para. 25 (b) of the proposal to amend Art. 1 of the Regulation (EU) No. 600/2014).

We see the proposal critically. A widening of powers is not required to fulfil regulatory purposes. MiFIR provides for product intervention rights against intermediaries. The UCITS Directive and AIFM Directive already provide the national supervisory authorities with basically wide-ranging power bases that include a distribution ban (AIFM Directive 2011/61/EU Annex I 2. b) in conjunction with Art. 45 para. 5, para. 6 and with Art. 46 para. 2 i); section 314 KAGB [German Investment Code]; Art. 9a OGAW V Directive 2014/91/EU; section 311 KAGB [German Investment Code]).

With regard to ESMA, it should be noted, furthermore, that, based on Art. 40 MiFIR, it has only subsidiary powers in the area of product intervention anyway in the case the national supervisory authorities remain idle or measures taken by them are not up to the threat (Art. 40 para. 2 (c) MiFIR and Art. 41 para. 2 (c) MiFIR). These "emergency competencies" for ESMA should therefore not be extended unnecessarily further.

II. New structure of transaction reporting – direct reporting to ESMA

Transaction reporting pursuant to Art. 26 MiFIR should be direct to ESMA (cf. Art. 6 para. 28 of the proposal to replace Art. 26 of Regulation (EU) No. 600/2014).

After an initial assessment, we see the proposal critically.

Reporting has a service function: it should enable the detection of market-abusive behaviour patterns and promotion of market transparency. In this regard, primary responsibility lies with the national supervisory authorities, so that the reports should in fact be directed to these. What is more, the realisation of new reporting infrastructures would involve considerable – mainly technical – effort with no adequate benefit to show for it. Above all, market participants, particularly small institutions, would still be dependent on qualified contacts at the national supervisory authorities to clarify day-to-day questions quickly and to ensure the smooth functioning of the reporting systems. Precisely against the background of the MiFIR implementation measures due to be instituted on 3 January 2018 in reporting, a renewed reorganisation so soon of the reporting channels should be avoided.

Reporting requirements currently already pose a huge operational burden: this should not be exacerbated.

F. Proposals to amend Regulation (EU) No. 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (Art. 8 of the Commission's proposal)

Art. 8 para. 12 of the proposal provides for the complete replacement of Art. 40 of Regulation (EU) No. 2016/1011, which deal with the powers of the competent authorities. By means of this provision, these powers are mostly assigned to ESMA. In this regard, differentiation is urgently needed, in our opinion.

So far as ESMA should be responsible for the supervision of administrators of critical benchmarks (cf. Art. 8 para. 12 of the proposal to replace Art. 40 of Regulation (EU) No. 2016/1011 – Art. 40 para. 1 (a) new), we agree with this transfer of power. Critical indices affect the EU-wide financial market, ESMA maintains its register and should be responsible for the supervision too. An example is Euribor, whose operator is supervised by the Belgian regulator, which is an anachronism. The same applies to the endorsement of third-country reference administrators.

Should responsibility for the supervision of contributors be transferred to ESMA too, however, then we reject this (cf. Art. 8 para. 12 of the proposal to replace Art. 40 of Regulation (EU) No. 2016/1011 – Art. 40 para. 1 (b) new). For the entities concerned, supervision by the national supervisory authorities is appropriate.

G. Lacking regulation-relevant aspects

I. Role of the national supervisory authorities

The competencies of the national supervisory authorities are not mentioned to an adequate extent in the proposal. The ESAs are essentially authorities that are backed by the supervisory authorities of the Member States. Against this background, the proposal to establish an Executive Board operating independently of the representatives of the national authorities has to be seen critically (for details, see C.II. above).

II. Legal protection against Level 3 measures

From a rule-of-law perspective, it is worrying that Level 3 measures are not justiciable. The proposed scrutiny by the EU Commission of Level 3 measures is a first step. However, we advocate genuine legal protection against measures of the ESAs.

III. Q&A

The Commission's draft does not address the issue of dealing with Q&A at all. In this regard, clarifications and improvements are urgently needed. Hence, in the three ESA regulations, it should be clearly stated that Q&A are not legally binding – a fact, by the way, that the ESAs themselves would not dispute. We suggest a more strongly regulated procedure for issuing Q&A that provides transparency about the development/formation of Q&A.

IV. Translation into the working languages of the EU

We would welcome the translation of all ESA texts into the working languages of the EU Commission. This includes drafts for consultations. In particular, small and medium-sized institutions cannot be expected to understand the complex English texts.

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